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BOOK REVIEWS

Accounting Systems

By John J. W. Neuner and Ulrich J. Neuner. International Textbook Company, Scranton, Pa., 1949. Pages: ix+386; $6.00.

As the authors have stated in the preface of the book "Accounting Systems" (Installation and Procedures) the work is intended, essentially, to instruct in the principles of system building and, incidentally, to illustrate certain accounting systems. The work, accordingly, may be considered to be both a manual of instruction for the student and an accounting guide for the practitioner.

This viewpoint is sound and reasonable and is quite acceptable, especially in the light of the impracticability of attempting to cover so expansive a subject as systems in a single volume. It is rightly conceded, therefore, that the book should not be considered the means of solving the manifold and specialized procedural problems which exist in modern enterprise. All organizations, whether of the profit or non-profit type, have their individualistic system problems.

The authors also point out the fallacies of the attempts, both past and present, to teach systems as a branch of accounting in the various colleges. A recent survey proved this to be the case, disclosing the wide diversity of methods employed in teaching this subject. Consequently, emphasis in this work is appropriately placed upon the principles of system building.

"Accounting Systems" divides the work of system building into two parts—one dealing with the principles, and the other with the application of these principles to various types of business problems. This is, unquestionably, the most desirable approach to the subject. The principles of system building set forth afford much substantial information for both student and practitioner. The former is not enmeshed in a winding and obtuse narrative style of exposition, but can follow the many step-by-step procedures simply and expeditiously; the latter can complement his practical experience by obtaining certain key and other information from this method of presentation. For the professional accountant this volume might be classed as a necessary part of independent research concerning a particular installation problem. This holds true whether the work of system building requires a partial or complete revision. Technical distinction between these two types of services has been made clear by the authors. The book, incidentally, includes valuable suggestions for accountants in the organizing of suitable information files related to their work in this field.

The book also contains considerable data relative to the proper and complete record-

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Book Reviews

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ng of many types of transactions that occur n both profit and non-profit enterprises. Numerous cases where specific performances re required are excellently illustrated in rderly sequence, augmented by an adequate rray of graphic charts and tabulations. The harts and other information can be easily ollowed and readily understood by the reader.

One should not expect to find entirely new rinciples here. The development and arrangement of the topical matter, however, is along uch lines as will enable the reader to form, learly and logically, proper concepts of hat constitutes a system installation. As a pecific example, the chapters on "Internal Check" follow the usual style of presentation f the somewhat standard protective features n the safeguarding of assets and income; ut, the information is detailed and developed n such a manner, as to permit immediate nderstanding of all the important points nvolved in examining records and leading o the performance of a well-balanced and atisfactory audit. The internal check discussion, as related to system structure, is

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Some Problems of Tax Law Administration in New York

By ALLEN J. GOODRICH, C.P.A.

I AM happy for the opportunity to talk with you about some of the problems inherent in the administration of the tax laws of New York State.

We have a great variety of duties in the Department of Taxation and Finance—ranging from motor vehicle regulation to veteran's bonus administration. But fundamentally, it is our job to administer the tax statutes which come to us through legislative processes. In so doing, we collect about 95% of all State tax revenues and thus provide financing not only for all of the manifold services of State Government, but also the hundreds of millions of dollars annually provided in the State's Local Assistance budget for the support of local government.

In the fiscal year ended March 31, 1950, the State collected $829 million in ordinary tax revenues and an extra $48 million in special taxes for interest on and retirement of veteran's war bonus bonds. Of this amount $278,000,000 was the yield from personal income and unincorporated business taxes.

In the brief time allotted to me, I intend to present some of the principles and convictions which motivated the administrative policies implementing the collection of those taxes.

The Income Tax Bureau of the Department of Taxation and Finance administers the personal income tax and the unincorporated business tax and bank tax under Articles 9-B and 9-C. Since all of these taxes are self-assessed, the Bureau is primarily concerned with processing payments, auditing the tax returns for compliance with the law, and adjudicating disputes with taxpayers.

Organizationally, the Income Tax

ALLEN J. GOODRICH, C.P.A., has been a State Tax Commissioner of the State of New York since 1948.

Mr. Goodrich began the practice of public accounting in 1922, and served as chief accountant (from 1935 through 1942) under Thomas E. Dewey, when the latter was special prosecutor and, later, District Attorney of New York County. He became Deputy Comptroller in charge of State Audits in 1943, and was placed in charge of the New York State Employees' Retirement System in 1948. He also served, by appointment of the Governor, as a member of several State Commissions.

This paper was recently presented by Mr. Goodrich at a regular meeting of the Society held on November 13, 1950, at the Hotel Roosevelt in New York City.

Bureau is under the direction of its director, and within the bureau are located two operating sections—collection and audit—and six service sections: Administration, Public Information, Regulation and Interpretations, Stenographic, Computing, and Files.

In 1947, Governor Dewey recommended and the State Legislature adopted an optional deduction of 10%, in lieu of itemizing deductions under the personal income tax law. This set the stage for the simplified New York State income tax form.

The State Tax Commission in that year introduced a new punch card blank employing the 10% deduction principle initiated in the State Income Tax Bureau. The new "Five Minute Finished Form" has been in use for three years and, for the 1949 tax year, 1,400,000 taxpayers used this form. It is hoped and expected that more and more taxpayers will become educated to its use as time goes on.

The benefits of simplification in reporting thus achieved are already widely realized by New York taxpayers. But not so well known is the fact that the new punch card form has revolutionized and established a new standard of businesslike tax administration in New York State. Mechanization of practically all operations, except the actual audit, has resulted in effective administration and collection of taxes.

This procedure makes possible:

1. Mechanization of a large part of the files operation.
2. Quicker discovery of taxpayer's failure to file.
3. Faster preparation of installment cards.
4. More rapid determination of taxpayer delinquency in payment and timely collection of these amounts.
5. Completion of the processing of one year's returns and substantial clearance of the delinquency collection on those returns before the receipt of the next year's returns.
6. One integrated mechanized system for mailing and processing returns, processing installment payments, and controlling delinquency.
7. An alphabetic index to each year's return which makes searches feasible while returns are in process of audit.

For the benefit of those who may be interested in this governmental adaption of the most modern procedures of business administration, I should like to discuss briefly the operations which illustrate New York punch card income tax system.

In discussing this, I should like first to summarize briefly the number of returns filed for the year 1949:

Form 200 (Punch Card Tax Blank)	
Tax paid returns	998,824
No tax—but required to file	317,000
Not required to file	132,000
Total	1,447,824
Form 201—(Long Form returns)	
Tax paid returns	1,587,188
No tax—but required to file	458,780
Not required to file	106,600
Total	2,152,568
Grand Total	3,600,392

As a result of the screening this year of the "no tax returns" filed, we will purge from the master file 238,000 names to which tax blanks will not be forwarded. This will result in a substantial saving of time and money in the years to come.

The installation of the new punched card return and processing system has taken place during the period which witnessed an increase from 2,500,000 tax returns to the present 3,600,000 returns and an increase of tax paid returns from 1,950,000 for 1945 to 2,585,000 for 1949, and an increase of installment payments from 125,000 to 513,000.

Processing Income Tax Returns

Turning now to the operations performed in processing income tax returns we might categorize these operations into 9 classes. The preliminary processing or sorting and examining of returns, the deposit operations, the billing of installments, the operations for the determination of delinquency, the checking of computuations on the returns, desk and field audit of returns, the issuance and collection of assessments, the issuance and collection of warrants.

Preliminary Processing

The preliminary processing consists primarily of the sorting of the different types of returns, the 200 or the short punched card form; the 201 or the long form residence return; the 202 or the individual unincorporated business tax return; the 203 or the non-resident return; the 204 or the partnership and unincorporated business tax return; and the 205 or the fiduciary return. The returns are also sorted as to tax or no tax, as to full paid or part paid, as to pre-addressed or not pre-addressed. They are separated as to those filed with District Offices and those filed with the Central Office. Those on which there are name or address changes are also separated so that these changes can be made. The various categories of returns are then examined for the correctness of the amount of tax due and the remittance. The remittances are examined to determine bankability and returns with correspondence are examined to determine the necessary action indicated by the correspondence. This completes the preliminary processing. I would like to point out that the number of pre-addressed returns we receive has a great influence on the facility with which we can process the returns since the amount of punching required on pre-addressed returns is much less than those not pre-addressed.

Deposit Operations

The next series of operations are those involving the deposit process. The returns are batched in groups of 50 by category; both the returns and remittances are serial numbered with the same number and an adding machine tape is run on the remittances to establish pre-determined batch totals. In the case of the pre-addressed short form, we punch only the personal service earnings, the serial number identifying the payment and the tax due and paid. The same information is punched from the pre-addressed long form returns, together with the social security number. The returns received which are not pre-addressed and those reflecting a change of address require full punching, including the full name and address of the taxpayer. All punching is mechanically verified. The short form returns and payment cards are then run through a tabulator for the purpose of deposit listing. This deposit listing contains the batch totals and this listing sheet is checked against the pre-determined adding machine tape remittance totals and discrepancies are reconciled. The remittances are then ready for deposit.

It should be remembered that this deposit must be completed by about the first week in June, since there is no appreciable bulk of returns until the 15th of April; the period during which approximately two million deposits must be made is seven to eight weeks.

Billing and Collection of Installment Accounts

The next series of operations are for the billing and collection of installment accounts. I mentioned earlier that the part paid returns were separated and that in punching the deposit card all of the information necessary for future billing is included therein. Since all this information is available when the initial deposit is made, all that is required for future billing is to reproduce the deposit card. The installment file is maintained by number. The original serial number which was stamped on the return as identification

of the remittance now becomes the account number. Future payments made to the account carry such number and are associated with and posted to such account. Inasmuch as this file is in account number order, it is necessary to reproduce an alphabetical file for reference purposes. This enables us to match the many installment payments received before installment bills have been mailed and for such accounts where the taxpayer failed to return the notice mailed to him.

Installment payments are deposited much in the same manner as the payments accompanying returns. Unmatched billing cards represent delinquents and are used for preparing a combined delinquency notice and for the next installment bill or request for the full amount due plus penalty. These unmatched billing cards are also used to prepare final notices on installments which remain unpaid after receiving the delinquency notice and before assessments are issued. Here again, it should be apreciated that the deposit matching and billing operations for a half million accounts must be performed in an eight to ten week period.

Delinquency Control

The next series of operations deals with the processing necessary for delinquency control. These operations begin with the matching of the payment cards with the master cards. The master cards are actually the previous year's payment cards which have been used for addressing the returns. This matching enables the completion of the punching of the name and address for pre-addressed returns by reproduction and eliminates considerable key punching. It enables the separation of the master or addressing cards of active or current taxpayers from a residue containing those who are no longer taxpayers or who have changed address, as well as delinquents and other miscellaneous groups. And it enables the separation of payment cards of new taxpayers, so that tax folders and other necessary material can be prepared in these cases. It enables the setting up of an addressing file, segregated as to long and short form, for the addressing of the next year's returns. It enables the setting up of the short form or 200 return file and it also enables the reproduction of the set of payment cards or audit cards for sorting by Social Security number, so that they can be matched with the 105 form or the employer's information returns.

The employer information returns for individual employees are filed by employers. The number of employers filing 105 forms with the State over a period of years has been much smaller than it should be. The compliance with this legal requirement has been very poor. The number of employers reporting the 1949 earnings of their employees was 92,374. The number of earnings reports received for the same period was 3,326,906. A study of this situation brought about the recent preparation of a master list of 417,000 employers who have one or more employees and who should be reporting to the State if their employees earn $1,100 or over in the case of single employees or $2,750 in the case of married employees. A system has been set up whereby punched card reports, form 106, will be sent to all employers employing one or more and requiring their indication as to why they do not file 105 information returns for those employees, or requiring the submission of the necessary 105 information returns with the 106 form. These 106 forms upon receipt from the employer will be matched against the 106 master file and the necessary action taken in following up employers who have failed to file 106 reports as well as the necessary 105's. This delinquency procedure on employer reporting will be put into effect in conjunction with the filing of 106's and 105's for the 1950 tax year.

Although employers are not required to file 105's for single employees earning less than $1,100, and for married employees earning less than $2,750

many employers prepare the 105's as a copy of the Federal W-2 and do not sort out those which are not required to be filed with the State. As a result, it is necessary upon receipt of 105's to sort them manually to eliminate those not required. The remainder are key punched with the Social Security number and earnings and where there is no Social Security number with 12 letters of the name and the earnings. These 105's are then sorted by Social Security number and earnings and matched with the payment cards which have been similarly sorted. Those that match on Social Security number and earnings can be discarded. Those that match on Social Security number alone must be manually compared for earnings discrepancies. Those that do not match on Social Security number are sorted alphabetically by name and are matched by name and earnings. Those that match by name only are manually examined for earnings discrepancies and those that do not match on name, the residue of all these matching processes, are the possible delinquents. Of course, there are many in this residue who may have filed a return but because of different social security numbers and different names used by the employers or as a result of errors made in interpreting the spelling of the name or in transposition of the digits of the Social Security number, either on the tax return or on the employer's report, it may be that some of the 105's in this residue are for taxpayers who actually have filed returns. Every effort is made to check these possible discrepancies before delinquency notices are sent out or before these cards are referred to the District Offices for field follow-up.

Computational Checking of Returns

Turning now from the punched card processing we have the preliminary operations which must be performed prior to audit. The long form returns are sorted down alphabetically, and inserted in the tax folder containing the previous two years' returns and are forwarded by letter for computing. Calculations on the return are checked by comptometer operators and schedule calculations are also checked and recomputed where necessary. Errors are indicated by the comptometer operators so that they can be taken into account by the auditors.

Audit of Returns

The returns proceed from the computing section to the various audit sections. The returns are audited against the previous year's returns and for compliance with the Tax Law and Regulations. When necessary, assessments or refunds are computed and the substantiation dictated for inclusion in the assessment or refund notice. Where necessary the desk auditor may remit cases for field audit.

Issuance and Collection of Assessments

Assessments prepared as a result of audit or the non-payment of installment bills are reviewed against the file before issuance to determine the existence of any previous outstanding assessments or outstanding tax due. Assessment payments are received and processed and unpaid assessments are followed up to attempt letter collection. Accounts which remain delinquent after follow-up are forwarded for warrant preparation.

Issuance and Collection of Warrants

The first step in field collection of outstanding taxes is with the field collector who makes contact in many cases and is able to close the account out without further action. Such cases which cannot be closed in this fashion are returned to Albany and a warrant is prepared for filing in the county clerk's office of the county in which the taxpayer is located.

In the case of deceased persons and bankrupt estates, claims are filed with representatives of the estate or the referee in bankruptcy. Uncollectible items are transferred to a special

account and the supporting documents are maintained in the files forever.

Whatever changes in our State tax law structure may lie ahead, it is, I think the character of the administration of them which will in large measure determine whether they are palatable or onerous; whether tax compliance is reasonably easy and inexpensive, or unreasonably complex and costly. It has been truly said that even a bad tax law can win acceptance under wise and understanding administration, whereas essentially good tax legislation can readily degenerate into injustices and inequities under faulty administration.

Principles Underlying Tax Administrative Policy

It is, therefore, important to examine the principles underlying our tax administrative policy. There are certain definite objectives which we strive for in our New York State tax administration under Commissioner Bates. Perhaps not all of these have been fully attained, but where the goal has not been reached we are striving steadily toward it.

Consultation With Taxpayer Representatives Before Instituting Major Changes

A well established policy of the Commission calls for full consultation with taxpayer representatives whenever a new provision of major consequence is under consideration. Proposed changes which seriously affect a particular industry are never instituted until the industry's suggestions have been sought. The result in every case has been that administrative pitfalls have been avoided, while the industry has been spared unnecessary disruptions or hardships resulting from arbitrary requirements. This consultation policy has paid off handsomely in taxpayer cooperation and, we believe, in more effective administration.

Prevention of Tax Evasion

We approach our job with the conviction that by far the greatest number of our taxpayers are honest; that informed of their just obligations, they will comply with reasonable requirements of the law simply as a matter of good citizenship. But while evaders represent a small minority of our taxpayers, their operations react against all taxpayers. It is inevitable that to the extent that taxes are evaded, the honest taxpayer is called upon to shoulder more than his fair share of the bill. Hence, as a matter of sound administration and for the protection of those who meet their tax obligations promptly and honestly, we have been tightening up our efforts to prevent tax evasion.

Departmental Adjustment of Tax Cases

Naturally, the tax statutes dictate the course of nearly every operation and our first duty is to carry out their intent as we see it and as the courts define it. But within this framework there must be a place always for principles of fair play and justice, and for full regard for the rights of the taxpayer. While the State tax administrator has the responsibility always to protect the interests of the State Government, he is in our view no less obligated to help preserve the rights of the taxpayer in our free society.

That is why the administrator finds himself frequently in the role of umpire in the determination of tax liabilities. And that is why more and more attention is given to conferences, formal and informal hearings, and review of our tax cases. All of these procedures are open to the taxpayer who disputes our findings. And, of course, he may take his case into the courts. But we find that most tax problems can be resolved at the conference table with due regard for both the interests of the State and the rights of the taxpayer.

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Recent Legislative Changes Affecting State Taxes

By MORTIMER M. KASSELL

YOUR Chairman has graciously assigned me a very broad topic, as you have probably noted from the all-inclusive title. However, I propose to be somewhat more circumspect than the title would indicate. I propose to deal with five or six of the more important amendments to the New York Tax Law made during the 1951 legislative session.

I would like to point out briefly that one of the most pressing problems in taxation is the need for some kind of coordination of the taxes imposed by the various levels of government. In many fields we have duplicate and overlapping taxes with the inevitable duplicate laws, duplicate returns, duplicate administration, and duplicate judicial rulings—and not necessarily in the sense of "same" but duplicate in the sense of "twofold." Our Federal and State income taxes are, of course, a classic example of this tax mess. We in New York are fortunate that we do not have, as Pennsylvania does, local income taxes. Otherwise, if you practise in different places you might well have to file income tax returns and pay income taxes to six or eight taxing authorities.

MORTIMER M. KASSELL, ESQ., is Deputy Commissioner of Taxation and Finance and Counsel to the New York State Tax Commission. He is a graduate of The College of the City of New York, 1926, and Columbia Law School, 1929. He is a member of the Executive Committee of the National Tax Association, a member of the Committee on Coordination of Federal, State and Local Taxes of the American Bar Association, a member of the Taxation Committee of the New York State Bar Association, and an advisory member of the New York State Joint Legislative Committee on Interstate Cooperation.

This paper was recently presented by Mr. Kassell at a regular meeting of the Society held on November 13, 1950, at the Hotel Roosevelt in New York City.

I mention in passing this broad problem of coordinating the tax systems because we, in this State, have been fortunate during the past twenty years in having a high degree of uniformity between the Federal and State estate tax systems.

The New York estate tax was adopted in 1930 as a result of joint recommendations of the Commission to Investigate Defects in the Laws of Estates and the State Tax Commission. Its objectives were threefold: First, to achieve uniformity of the New York and Federal estate tax so that there could be similar reports, similar administration and similar interpretations, both administrative and judicial. Second, to obviate the confusion that then existed under the New York dual system of death taxes—an inheritance tax and the temporary estate tax. Third, to insure that New York receive the full benefit of the Federal credit.

This policy of uniformity has prevailed in our courts and in our Legislature for over twenty years. Numerous judicial decisions emphasize that great weight is to be given decisions of the Supreme Court of the United States interpreting the corresponding provisions in the Federal law. The Legislature has amended the New York estate tax every year or so in order to conform with changes made to the Federal Estate Tax Law. In fact, two

of the amendments we will consider relate to the estate tax imposed by Article 10-C of the Tax Law.

Estate Tax Amendments

One of the amendments relates to the death taxation of certain *inter vivos* transfers, such as those where the grantor retains to himself the life interest in the income.

It had long been settled in this State that a transfer of this type was taxable as a "transfer intended" (*Matter of Green,* (1897), 153 N. Y. 223; *Matter of Brandreth* (1902), 169 N. Y. 437 and *Matter of Cornell* (1909), 170 N. Y. 423). This interpretation had prevailed under the various types of death taxation that existed in this State before 1930. However, shortly after that date the Supreme Court of the United States decided that such transfers were not taxable as "transfers intended", if they were created before the enactment of legislation specifically including them in the gross estate—the famous Joint Resolution of March 3, 1931. (*May* v. *Heiner,* 281 U. S. 238). The corresponding New York amendment was made by Chapter 62 of the Laws of 1931, effective March 8, 1931. Despite the earlier New York history, our courts decided that the policy of following the Federal law must be adhered to (*Matter of Sandford,* 277 N. Y. 323; *Matter of Van Wagenen,* 258 App. Div. 846, appeal denied 282 N. Y. 810), and accordingly also held that these transfers made before March 8, 1931, were not taxable.

This situation existed until January 27, 1949, when the Supreme Court in *Commissioner* v. *Church,* 335 U. S. 632, reversing its earlier decisions, finally held that these transfers were subject to tax.

The Congress promptly recognized that considerable hardship would result, because many transfers with income reserved had been made in reliance on the earlier decisions. It therefore enacted the so-called Technical Changes Act of 1949 (approved on October 25, 1949) which is designed primarily to provide an escape for taxpayers who reserved life income under trusts created by them prior to the Joint Resolution.

The New York Tax Commission promptly recognized the inequity of changing the rules in the middle of the game, and recommended to the Legislature the bill which became Chapter 683. Insofar as practicable it follows the Federal amendments and permits the release, prior to January 1, 1951, of the income reserved in a transfer made before March 31, 1950, without any liability for the New York estate tax. However, it leaves such transfers taxable in the estates of future decedents if the right to income is not released.

One important difference between the two acts must be emphasized. The Federal law exempted such transfers from tax in the estate of any decedent who died prior to January 1, 1950, and made provision for refunds in cases where any such tax had been paid. The New York law is not retroactive. It does not authorize any refunds. In other words, in the case of the estate of a New York decedent who died before May 1, 1950, such transfers will be subject to the New York estate tax even though they would not be subject to the Federal estate tax.

The same situation obtains with respect to certain other types of *inter vivos* transfers where the grantor retains some interest however remote and whether or not expressly reserved. Here, too, the New York statute follows in general the Federal statute but is not retroactive. The New York law exempts from tax transfers made prior to October 8, 1949, unless the possibility of reverter was expressly reserved and was worth more than 5% of the full value of the property transferred. In addition to affording some tax relief, it also makes it clear that transfers made after October 7, 1949, where the property can pass only to

persons who must survive the decedent, even though the decedent retained no interest in the property after the transfer, are taxable. Here, too, the New York law differs from the Federal in that it is not retroactive. While the Federal law permits refunds if the decedent died after February 10, 1939 (provided a claim for refund is filed by October 25, 1950), the New York law is prospective only applying to estates of decedents dying on or after May 1, 1950.

I realize the foregoing is necessarily a highly technical discussion of a highly technical field. I merely wish to point out the advisability of reviewing any such *inter vivos* trusts with these new tax effects in mind.

The other estate tax amendment is also highly technical but because of its importance should be carefully studied. I refer to Chapter 585 of the Laws of 1950. This also continues the policy of conforming to the Federal Estate Tax Law, by allowing a so-called "marital deduction" similar to that allowed for Federal estate tax purposes by the Revenue Act of 1948. The provisions of the New York law were copied almost verbatim from the Federal law.

Here again, a brief examination of its background may be helpful. As you know, residents of New York and their estates have for many years been at a great disadvantage taxwise as compared with residents of community property states. As far back as 1935, I can recall the then State Tax Commission considering the possibility of New York adopting a community property system in order to take advantage of the tax benefits allowed under the Federal law. In 1942, the Congress endeavored to equalize these tax burdens by special treatment of community property estates, but this was not a satisfactory solution, because the residents of community property states contended that under some circumstances the amendment taxed them more heavily than residents of other states. In 1947, a large number of additional states adopted the community property system and even this State gave some consideration to such a move. As a result, the Congress enacted the Revenue Act of 1948, which allows a so-called "marital deduction" in computing the Federal estate tax.

New York was immediately placed on the horns of a dilemma. From one view, in order to carry out our well-established legislative and judicial policy, it was imperative to conform to the Federal change. On the other hand a substantial loss of revenue, estimated at almost 30%, would immediately occur. Furthermore, since some states, such as Florida, had an estate tax law which merely absorbed the 80% credit, we were in danger of losing some large estates, since the New York tax could easily be three or more times that of a state which only took up the 80% credit. In one instance that came to my attention shortly after the adoption of the marital deduction idea, the New York tax was almost $400,000 while the Florida tax was about $125,000. For these and similar reasons there was introduced in the Legislature the bill which eventually became Chapter 585.

Because of its highly technical provisions and the fact that most of us will have to live under it and some of us die under it, I propose to consider them in some detail, although I recognize that is not an easy job from this platform.

The statute allows to the estate of a decedent who died on and after October 1, 1950, and who is survived by husband or wife, the so-called "marital deduction." In general, it may be said that this permits a married person, either husband or wife, to transfer to the other, at death, up to one-half of his estate without liability for estate tax. All property interests which pass to a surviving spouse which are included in the gross estate are considered in determining the marital deduction. Of course, if a decedent does not give his spouse one-half of his estate, a

deduction is allowable only for the value of what he does give her, but even though he gives her everything, this deduction can be allowed for no more than one-half of the adjusted gross estate. The maximum limit of the marital deduction is 50% of what the statute calls the "adjusted gross estate." This is a new concept in estate taxation. It is the gross estate less debts, mortgages, funeral and administration expenses, and amounts expended for the support of dependents during administration of the estate.

The general theory of the statute is briefly as follows:

Under the former statute if a husband was survived by a wife and children, and transferred his entire estate to the wife, there was one tax on that transfer and a second tax when the wife died. The principal means of avoiding this second tax, particularly in the larger estates, was to create a trust for the life of the wife with remainder to the children. The difficulty with this was that such trust did not give the wife enough leeway, and frequently the husband wanted her to have some control over the principal. Now, by virtue of the marital deduction, a husband may give his wife one-half of his estate outright, free of tax burden, and, to the extent of this one-half, there will be neither double tax before the property ultimately passes to the children (after the wife's death) nor any need for limiting the wife's interest to something less than the outright ownership.

Of course, as to this one-half of his estate which the statute contemplates that the husband may give his wife, it is intended that at least one tax shall be paid before the property ultimately gets out of the husband-and-wife partnership. Consequently, the law is drawn so that no transfer by one spouse to the other can qualify for the marital deduction unless it is such that the property will be subject to tax in her estate if she still owns it when she dies. This is accomplished by allowing the deduction, generally speaking, only for outright transfers to the surviving spouse or for trust transfers for her benefit which are coupled with an unrestricted power of appointment in her. If a decedent creates for his spouse a trust for her life without such a power of appointment, the value of her interest in the trust is not deductible.

The statutory provisions which bring about this result are quite complex, but I may summarize them by saying that the deduction is denied if the decedent gives his surviving spouse what is called a "terminable interest"—that is, a temporary or contingent estate—after which possession of the same property may pass to a third party to whom the decedent has given the remainder or any other interest in such property.

Various other amendments relating to the deduction for previously taxed property and to exemptions, were also made in order to avoid the allowance of a double tax benefit.

Thus far I have dealt with the estate tax and with two highly technical amendments. The only excuse I can offer is that this cursory review should, at least, serve the purpose of causing you to review again any wills and trusts you may have, particularly with the marital deduction in mind.

Corporation Tax Amendments

Two amendments made to the corporation tax laws at the past session should be mentioned.

A major change to Article 9-A, which imposes the franchise tax on business corporations, was made by Chapter 20 of the Laws of 1950. This amendment will affect almost 44,000 corporations in this State. It provides that all corporations which are on a fiscal year basis must file reports and pay at least one-half of the tax, within three and a half months after the close of their fiscal year, and must pay the balance of the tax within three and a half months after the date on which the report was required to be filed. No change was made with respect to corporations which report on a calendar year basis. The reason for the amendment was the fact that under the old law July,

August, September, October, and November fiscal year corporations were not required to file any report or to pay any tax until the following May fifteenth. The balance of the tax was frequently not due until January fifteenth of the year following the due date of the report. As a result, in some instances franchise taxes were not received until almost a year and a half after the close of the corporation's fiscal year. This amendment will cure this absurd time lag. It applies to all corporations whose fiscal year ended on or after July 31, 1950.

Minor amendments were also made to section 182 of the Tax Law which imposes the franchise tax on real estate corporations. One amendment will tax as a "dividend" any excess paid by a corporation in purchasing its own stock over the amount paid in on such stock. The other amendment would prorate the tax under section 182, where a real estate corporation changes its classification and becomes subject to tax as a business corporation under Article 9-A (Chapter 52).

Unincorporated Business and Personal Income Tax Amendments

As you know, the reduction in the unincorporated business income tax rates from 4% to 3% was continued and the personal income tax rates were 90% of the normal rate. One other amendment in this field is noteworthy. It provides that with respect to personal income tax returns due on or after April 15, 1951, depreciation applicable to real property acquired on or after January 1, 1919, during its use as a personal residence by the taxpayer will be disregarded in adjusting the cost basis of the property for the computation of gain or loss derived upon its sale for personal income tax purposes. Under the present provisions of the Tax Law, a taxpayer is required in all cases to adjust the cost basis of property sold to reflect depreciation. For Federal income tax purposes, such depreciation (sustained subsequent to the enactment of the Federal Income Tax Law) is disregarded in computing the gain on the sale of property devoted to personal use. Chapter 500 brings the New York law in line with the Federal law with respect to the treatment of depreciation. However, there are some important differences. First, under the Federal law, no capital loss on the sale of a personal residence is allowable. Second, the New York amendment applies only to such property acquired by purchase after the enactment of the New York personal income tax law (January 1, 1919). Third, the New York amendment does not apply to property acquired by gift or devise.

One other point should be mentioned. Inevitably we examine into only those bills which are enacted into law. However, hundreds of tax bills are introduced each session. For example, many bills are introduced which would allow special exemptions or deductions for personal income tax purposes. While none were enacted into law, notice should be taken of what is probably the classic example of "incentive" taxation. It is the bill which would have provided an exemption of $400 for each of the first two children, $600 for the third child, $800 for the fourth child, and $1,000 for the fifth and each additional child.

Perhaps I can best summarize what I have said by pointing out that the past legislative session was not productive of any basic changes in the New York tax structure although many improvements and changes were made. The outstanding contributions were the adoption of the marital deduction in estate taxes, the reduction in the rates of personal income and unincorporated business income taxes and the change in the reporting date under Article 9-A for fiscal year corporations.

Should Retailers Adopt Lifo This Year?

By J. P. Friedman, C.P.A.

The increase in prices as a result of the Korean War has again made LIFO a live subject. Those not now on the LIFO basis, whether they are in retailing or in other lines of business, are attempting to determine whether this is the year to adopt LIFO.

Description of the LIFO Method

If those who are familiar with LIFO will bear with me, I will start by giving a brief description of the LIFO method for the benefit of the uninitiated. If two identical articles are bought, the first for $1.00 and, at a later date, a second one for $1.10 and one of the articles is sold for $1.60, how much is the profit? One answer is that the profit is 60¢—the difference between the first article bought for $1.00 and the sales price of $1.60. This is called FIFO—first-in, first-out. A second answer is that the profit is 50¢—the difference between the $1.10 cost of the second article purchased and the $1.60 sales price. This is called LIFO—last-in, first-out. We have all been accustomed, traditionally, to think of profits in the terms of FIFO. Of those who have given the subject considerable thought, many have come to the conclusion that FIFO is not a realistic method. They have reached that decision because they find that each business attempts to keep a more or less uniform quantity of inventory on hand at year-ends, and they contend that it is unrealistic to write this basic inventory up or down as prices fluctuate. They state that what really takes place is that, in effect, they merely sell what they bought recently as evidenced by the fact that the quantities in the inventory tend to remain constant. It is for that reason that the LIFO method makes no change in the prices of the opening inventory quantities and it includes in cost of sales, not the opening inventory, but the cost of replacement for an equivalent quantity of merchandise.

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In the case of copper, silver, oil and other natural resources, LIFO is calculated by specifically identifying quantities. For example, it is known that there were so many tons of a particular grade of copper on hand at the beginning of the year, so that this number of tons continues to be priced at the end of the year at the same price per ton as at the beginning of the year. For retailers' inventories, where many of the items tend to change in character from year to year because of the style element and because of customers' wishes, it is not possible to identify the quantities item by item and, therefore, the same result as in the case of the copper is achieved by the use of a price index.

The Bureau of Labor Statistics of the U. S. Department of Labor prepares an index semi-annually as of January and July of each year which

compares prices with those prevailing at January, 1941. It uses 100 as the index as of January, 1941, and the total store index for January, 1950 was 173.5. At July, 1950, it was 174.8, so that by comparing the two figures, the percentage of price rise can be computed readily. The selling departments in a store are divided into ten groups and a separate B.L.S. price index is prepared for each of the ten, from which the total store index is prepared. For example, the first group is entitled "Piece goods, domestics and draperies" and all departments which sell goods of the characters described must use the price index developed for Group I. The method of applying the price index to inventories at retail by departments is explained in the publications of the Controllers' Congress of the N.R.D.G.A.

I have often been asked whether the LIFO calculations take a long time. They do take quite a little time the first year, but thereafter it should be possible for one person to make the calculations in two or three days in a large store with somewhat less time in a smaller one.

It should be explained that the LIFO figures are not used for buyers and for operating reports on the departmental level. The stores on LIFO have continued to use the regular retail inventory figures for such purposes. The departmental statistical records remain unchanged.

Advantages of LIFO Inventories

Many people regard LIFO as merely something invented for the purpose of reducing taxes. As a matter of fact, the base stock method, which is quite similar to LIFO, antedates LIFO by a great many years. I still remember the audit of a mining company which I made in 1919 where I found that the company had been using the base stock method for many years prior thereto. It could not use this method for tax purposes, but nevertheless it prepared its financial statements on that basis because it believed that such a basis allowed it to present more fairly the results of its operations. There were a number of companies which used the base stock method or some adaptation thereof for many years before LIFO was allowed for tax purposes.

The thought was, in all of these cases, that by keeping a constant quantity of inventory at a fixed price, the fluctuations in the price level of that quantity would be excluded from the determination of earnings. Therefore, the method tended to show earnings as being lower in years of rising prices and higher in years of falling prices. Because the good years did not look quite as good, and the bad years did not look quite as poor, this method tended to make management decisions less volatile. The only difficulty with the method was that, as it was not allowed for tax purposes, the deductions for income tax in good years tended to be too high in relation to reported earnings and in poor years too low. With the enactment of the LIFO provisions into law, the income tax deductions began to bear a reasonable relationship to the reported earnings, and this made LIFO even a better managerial tool.

It would now be possible to state unequivocally that for many businesses, including retailing, the LIFO method is preferable to FIFO and that it should be adopted immediately were it not for one flaw in the tax law. For taxpayers on the FIFO basis, inventories may be priced at cost or market, whichever is lower, so that if an article can be replaced at less than cost, it can be inventoried at the lower figure. For taxpayers on the LIFO basis, however, the cost or market rule is not applicable and, therefore, taxpayers on the LIFO basis must always use LIFO cost, even if market is lower. This is an unfair discrimination against LIFO taxpayers and, it is in order to obviate difficulties under this rule, that an unequivocal answer cannot be given. LIFO must be adopted in a period when it is reasonable to expect that there will be a

rise in prices and when there is little likelihood that the price level will decline to a point lower than that in effect when it was adopted; otherwise the LIFO taxpayer will be at a disadvantage compared with the FIFO one, because a LIFO taxpayer will not be in a position to write down his inventories below the prices at the date of the adoption of the LIFO method.

Experience with LIFO

Some idea as to the extent to which LIFO is used by publicly listed companies may be gathered from a survey of the American Institute of Accountants of financial reports for fiscal years ending July 1, 1948, to June 30, 1949. This report showed that, of the 525 corporations, 96 indicated that they used the LIFO basis, representing about 18% of the total. Considering how little LIFO was understood at the beginning of the second World War, this is a higher percentage than might have been anticipated.

It may be interesting at this point to give you some statistics compiled from the published reports of a few of the retailing companies which adopted LIFO for the year ended January 31, 1942, which abandoned it when the Treasury Department indicated that the LIFO method was not available to retailers, and which readopted it after the *Hutzler* decision in 1947. Three of these companies—Gimbel, Macy and May—showed in their reports for the year ended January 31, 1948, the effect on inventories and taxes of the use of the LIFO method for the entire period of seven years then ended.

On the average, the inventories of these three companies at January 31, 1948, would have been approximately 40% higher on the FIFO basis than they were on the LIFO basis; this compared with the B.L.S. total store index increase of 80.5% since January 31, 1941. It will be seen that the percentage decrease in inventories, as a result of the use of LIFO, was considerably lower than the percentage by which the index has increased. This difference resulted from the fact that the quantities of inventory had risen in the intervening years. The increase in the price level shown by the LIFO price index is deducted in its entirety only from the quantities on hand at the time LIFO was adopted; as to subsequent increases in inventory quantities, the deduction represents only such portion of the price index increase as arose after the dates of the inventory increases.

The reports of these three companies also showed that the combined reduction in federal income and excess-profits taxes for the seven-year period aggregated approximately $22,400,000.

Considerations in the Adoption of LIFO This Year

I have previously referred to the fact that LIFO is a cost basis and not a cost or market basis. The law requires that in the year of adoption of LIFO, both the inventories at the beginning and end of the year must be placed on a cost basis. Because the retail method is a cost or market basis, this means an increase in the opening inventory and this increase must be reported as taxable income for the year preceding the one in which the change to LIFO is made. The increase will amount to approximately the percentage of markdowns applied to inventories; last year the percentage averaged about 6%. In other words, the departmental inventories at January 31, 1950, must be recomputed by deducting from the retail figures, not the percentages of original marking, but the percentages of maintained marking, and this will result in inventories which are higher by about 6%. It is this increase which must be reported as additional taxable income for the year ended January 31, 1950, in an amended federal income tax return to be filed for that year if LIFO is to be adopted for the year ending January 31, 1951.

The tax on this increase in taxable income will represent a considerable

cost for the adoption of LIFO inventories and, therefore, unless there is a rise in the price index by January, 1951, of at least about the percentage of mark-downs for the preceding year, there will be no immediate net tax gain from the adoption of LIFO for the year ending January 31, 1951, except that from the slight differential in tax rates between that year and the preceding one. The net tax advantage in the year ending January 31, 1951, is not likely to be very great. What is more important, therefore, is the probable tax advantage or disadvantage over a period of future years and this, in turn, depends upon three factors—the expected price level, the expected tax rates, and the expected size of inventories.

There are many reasons for expecting a substantial increase in the price level. Defense expenditures have commenced, and will continue, to be made in increasing amounts. We are already witnessing another round of wage increases. The number of employed is increasing steadily. Tax rates have been increased and are to be raised higher. As a result of the diversion of a greater percentage of productive capacity to defense needs, we see before us the same pattern of increasing consumer prices with which we became so familiar during, and following, the second World War. The entire philosophy of the Washington Administration tends inevitably toward an increased price level.

We all know, though, that periods of stress tend to come to an end, and that price levels usually recede thereafter. Is it likely that such a recession will bring the price level below what it was in January, 1950, as of which date the adoption of LIFO is being considered? If the answer were in the affirmative, and there were no differential in tax rates amongst the years, then there would be a tax disadvantage from the use of LIFO because, as already explained, the LIFO taxpayer could not write down inventories below cost at the date of the adoption of that method. But a uniform tax rate is not likely as we know from the Congressional discussions of an excess profits tax. If the history of the second World War is any indication, then we shall again find that we shall have higher tax rates in years of increasing price levels and lower tax rates in years when price levels decline. Under such circumstances, it is likely that there will be a net tax advantage from the use of LIFO even if the price level declines below that of January, 1950, although the amount of the advantage will necessarily depend upon the degree of decline below that level and the extent of the differential in tax rates between the years when prices are rising and declining.

Are we likely, however, to have a decline in the price level below that in January, 1950? In the period following the first World War, there were substantial declines in the price level in 1921 and during 1929 to 1933 but these declines left the price level considerably above where it had been in 1914. Following the second World War, the B.L.S. retail price index receded only slightly to a low point of 173.5 in January, 1950. At this low point, therefore, the index was still 73.5% higher than the 100 in January, 1941, and January, 1941, in turn, was higher than the price level in 1939 at the outbreak of the second World War. It is always dangerous to reason by analogy because conditions during two periods are never quite the same; in the present instance, however, there are sufficient similarities so that the results are not likely to be substantially different. On the basis of past experience, it seems probable that the price level will not decline below that in January, 1950.

The second consideration in the adoption of LIFO is the expected tax rates which will be in effect over a period of years. We are commencing to pay taxes at higher rates and, whether we have an excess profits tax or not, we know that future tax rates will be even

higher. After a period of years, rates should be lower. The pattern which is repeating itself, of higher tax rates while prices are rising and lower rates while they are declining, represents a powerful stimulus for the adoption of LIFO at this time.

The third factor to be considered in deciding whether to adopt LIFO this year is the expected size of the inventory. LIFO is a method of maintaining inventories at a fixed cost. However, if the amount of inventory is reduced in subsequent years, the effect will be to exclude taxable income from the return for the year ending January 31, 1951, at 1950 rates and, instead, to include it in taxable income for subsequent years at what probably will be much higher rates. This would have been the situation at the time of the second World War in the case of radios, washing machines, electrical appliances and similar articles, the production of which was discontinued, had it not been for a special provision in the tax law dealing with involuntary liquidation of inventories.

This section of the law states that, if goods were involuntarily liquidated, the low cost of such goods in the beginning inventory is to be included in cost of sales, resulting in an unusually large profit. However, if the goods are subsequently replaced, a refund claim could be filed for the year of liquidation in which the cost of replacement of the goods was substituted for the amount originally included in cost of sales, thus reducing income to the extent of the excess replacement cost. Accordingly, while increased taxes would be paid at the time of involuntary liquidation, they would be recovered when the goods were replaced.

Unfortunately, there are no involuntary liquidation provisions of the same type in the present law and, therefore, if it is anticipated that there will be reducing inventories because of shortages or otherwise, the effect upon the tax of these reductions must be taken into consideration. While it is likely that the involuntary liquidation provisions will be reenacted if there should be important shortages, this is not at all certain.

Summary and Conclusion

The situation may now be summarized. It is probable that the increase in the price level between January, 1950, and January, 1951, will be high enough so that the resultant reduction in taxable income for the year ending January 31, 1951, from the adoption of LIFO for that year will be greater than the addition to taxable income for the preceding year from the increase of inventories from cost or market to cost. It is probable that the increase in tax rates and the further increases in the price level in subsequent years will result in large tax savings during those years and that the subsequent decline in prices will not result in the return of more than a portion of these savings. It is quite likely that the quantities of inventories in certain lines will be reduced because of shortages and that this will have a negative effect from the point of view of the adoption of LIFO but it is also possible, if these shortages should attain serious proportions, that an involuntary liquidation provision will be reenacted.

I conclude, therefore, that it is likely to be advisable for retailers to adopt LIFO this year. However, no decision need be reached until the time financial statements for the year and federal income tax returns are to be filed. If LIFO is to be used for tax purposes, it must also be used for financial statement purposes. The tax returns for the year ending January 31, 1951, need not be filed until April 15, 1951, at the earliest, and by that time the B.L.S. retail price index will be available and it will be possible to know how much of an increase in the price level there has been. It will also be possible to know whether commodity shortages are appearing on the horizon and to measure their effect. At that time calculations can be made which will show the picture for the past year a little more clearly.

Investment Company Accounting

By Ralph H. Galpin, C.P.A.

Investment company accounting, since the passage of the Investment Company Act of 1940, has probably attained greater uniformity without loss of simplicity and clarity than in the case of any other type of business. In some respects, particularly in the distinction maintained between ordinary income and appreciation in value of assets, realized or unrealized, it may provide the germ for improvements in commercial and industrial accounting. With the current resurgence of interest in investment companies a look at the present status of investment company accounting requirements and the independent public accountant's relationship thereto may be worth while.

The Investment Company Act of 1940 was passed with the stated purpose of correcting a number of abuses found as a result of a Congressional study. One of the abuses found was the employment of unsound and misleading accounting methods and lack of adequate independent scrutiny thereof. These and other undesirable conditions noted are dealt with in various sections of the act, which is administered by the Securities and Exchange Commission. Of particular interest to independent accountants are Sections 8, 17(f), 30, 31 and 32.

Accounting Requirements Under Investment Company Act

Section 32 governs the appointment of independent public accountants and provides: (1) that they shall be selected by a majority of the "outside" directors, (2) that the selection shall be submitted, for ratification or rejection, to the next annual meeting of stockholders, (3) that the selection shall be conditioned upon the right to terminate the employment at any time upon the vote of a majority of the outstanding voting securities, and (4) that the accountant's certificate or report shall be addressed to the Board of Directors and to the security holders.

Section 31 states that the Commission may issue rules providing for a reasonable degree of uniformity in accounting policies and principles in maintaining accounting records and in preparing financial statements. Regulation S-X as it applies to investment companies together with opinions contained in accounting releases represent the rules that have been issued in this connection.

Section 30 governs the submission of annual reports to the Commission (which include certified financial statements — but this requirement may in part be satisfied by filing a copy of the annual report to stockholders). This section and the rules thereunder also prescribe a form of quarterly report to be filed with the Commission. The section in addition provides that reports containing certain prescribed financial statements shall be transmitted at least semi-annually to stockholders and that four copies of every periodic or interim report or similar communication sent to stockholders and containing financial statements shall be filed with the Commission within ten days. Finally the section deals with the form of certificate of independent public accountants to accompany annual reports whether to the Commission or to stockholders. Thereunder is a requirement that each such certificate shall state that the

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accountants have verified securities owned, either by actual examination, or by receipt of a certificate from the custodian.

Section 17(f) deals with the custody of securities owned by an investment company and provides that they may be held (1) in the custody of a bank, (2) in the custody of a member of a national securities exchange, or (3) in the custody of the company (securities in the custody of a bank which may be withdrawn upon mere receipt of directors, officers, employees or agents are deemed to be in the custody of the company). Independent public accountants are required to verify the securities by actual examination (1) if they are held in the custody of a member of a national securities exchange, at the end of each annual and semi-annual fiscal period and at one other time during the year or (2) if in the custody of the company, at least three times during each fiscal year, two of which shall be chosen by the accountant without prior notice to the company. In either case a certificate from the accountant stating that he has made the examination and describing its nature and extent is to be transmitted to the Commission by the accountant promptly after each examination.

Section 8 provides for the original registration of companies under the Investment Company Act. The forms to be filed include certified financial statements.

Investment Company Defined

An investment company is defined in the act, in general, as any issuer which

1. is . . . engaged primarily . . . in the business, of investing . . . or trading in securities,
2. is engaged . . . in . . . issuing face amount certificates of the installment type or . . . has any such certificate outstanding, or
3. is engaged . . . in the business of investing, . . . owning, holding or trading in securities, and owns . . . investment securities having a value exceeding 40 per cent of the value of such issuer's total assets (exclusive of Government securities and cash items) . . . .

The term "investment securities" excludes (a) Government securities, (b) securities issued by employee's securities companies and (c) securities of majority-owned subsidiaries which are not themselves investment companies.

Several types of companies which would fall within the general rule are specifically excepted from the definition of investment company. These include:

1. Issuers, together with any wholly-owned subsidiary, primarily engaged in other businesses through wholly-owned subsidiaries or, if so ordered by the Commission upon application, through majority-owned subsidiaries or controlled companies conducting similar types of businesses (a controlled company under the Investment Company Act is one in which 25% of the voting securities are owned)
2. Issuers whose securities are owned beneficially by not more than 100 persons, but if more than 10% are owned by a company the beneficial owners shall be considered to be the security holders of such company
3. Security dealers, brokers, banks, insurance companies, common trust funds maintained by banks, finance companies
4. Companies subject to the Interstate Commerce Act or the Public Utiity Holding Company Act
5. Companies substantially all of whose business consists of holding oil, gas or mineral interests
6. Charitable, educational and religious organizations
7. Pension or profit-sharing trusts qualified under Section 165 of the Internal Revenue Code.

Classes of Investment Companies

Those companies which are invest-

ment companies fall into six classifications. These, with the total of each type registered with the Securities and Exchange Commission at December 31, 1949, are as follows:

Face amount certificate companies..	16
Unit investment trusts	96
Management companies which comprise four classes:	
Open-end-diversified	134
Open-end-non-diversified	14
Closed-end-diversified	38
Closed-end-non-diversified	69
A total for the six of........	367

Face amount certificate companies issue face-amount certificates payable by the certificate holder in installments. Unit investment trusts issue redeemable securities which represent an undivided interest in a unit of a stated number of shares of various securities. All other types are called management companies, but there is a distinct differentiation between "open-end" and "closed-end" management companies.

An open-end management company is one in which the stockholder has the right at any time to compel the company to redeem his shares at asset value and conversely these companies are continually selling additional shares at the asset value with a sales commission being added which goes to the underwriters or distributors of such shares.

Closed-end companies do not undertake to redeem shares and their capital structure is more fixed in nature although they do at times purchase their own securities in the open market and float additional security issues.

A diversified company, either open-end or closed-end, is one at least 75% of the value of whose assets consist of cash and cash items and securities, the investment in the securities included in the 75% test being limited so that not more than 5% of total assets are invested in the securities of any one issuer and not more than 10% of the voting securities of any one issuer are owned (it not being required to include government securities or securities of other investment companies in either the 5% or 10% test). It should be noted that under this rule 25% of assets may be invested in securities of any one issuer, or up to 25% may be invested in more than one issuer in excess of 5% of assets in each or in exess of 10% of their outstanding securities, without losing the status of a diversified company. As indicated in the table previously given, most open-end companies are diversified whereas about two-thirds of the closed-end companies are non-diversified.

At this point it might be well to mention another title used in connection with investment companies, namely, "regulated investment company." This is a term applied in the Internal Revenue Code to those investment companies subject to the Investment Company Act of 1940 which, if they meet certain tests, principally that of diversification, may elect to be taxed only on that portion of ordinary income and long term capital gains which they do not distribute to stockholders during the taxable year. Many investment companies have elected to be taxed on this basis.

Financial Statements

The financial statements of management investment companies are described in a general way below. The statements of face amount certificate companies and unit investment trusts are somewhat different.

With Article 6 of Regulation S-X setting forth in considerable detail the form and content of financial statements for management investment companies filed with the Securities and Exchange Commission, and with the financial statements for the semi-annual reports to stockholders prescribed in the Investment Company Act itself, a considerable uniformity has developed in the statements for these companies. This is especially true for the open-end companies whose statements have broken away from the traditional form of balance sheet particularly in the

showing of capital stock, capital surplus and earned surplus. To some extent these changed statements are also used by closed-end companies if they carry assets at market value. All open-end companies must carry assets at market or other current values; closed-end companies have the option of carrying assets at cost with market shown parenthetically. The balance sheet has been replaced by a statement of assets and liabilities which deducts liabilities from assets to arrive at net assets applicable to capital shares with a statement of the shares outstanding and value per share. As a balance against this figure open-end companies with only one class of stock may use an analysis of the source of the net assets rather than the customary showing of par or stated value of stock, paid-in surplus, earned surplus, and unrealized appreciation. This analysis shows the total amount paid in for capital shares from inception less amounts paid out on redemptions and less any distributions paid from capital sources, adds net realized gains on sales of investments less distributions therefrom, adds the balance of undistributed income, and finally the unrealized appreciation of investments. It will be observed that these forms are similar to the simplified statement of financial position adopted in recent years by several industrial companies.

In lieu of an analysis of any surplus accounts a statement analyzing the changes in net assets for the year or other reporting period is given. This starts with net assets at the beginning of the period, adds net income and equalization amounts paid in with new shares less dividends paid from such sources, adds net gain on sale of investments less dividends paid therefrom, adds the increase in unrealized appreciation of investments, and finally adds amounts paid in for additional shares of stock issued less amounts paid out on repurchases, arriving at net assets at the end of the period. This statement of changes in net assets may be used by any open-end company and also by a closed-end company if its assets are carried at market or other current values.

The requirement for statements to be included in annual and semi-annual reports to stockholders contained in the Act are not strictly conformed with the requirements in Regulation S-X which cover only statements to be filed directly with the Commission. It should be remembered, however, that if the year-end report to stockholders conforms substantially to the requirements of S-X a copy thereof may be filed in lieu of financial statements required by S-X in the annual report to the Commission provided the necessary supporting schedules are filed. Further, the Commission in Accounting Series Release 57 has stated that in their opinion it would not be appropriate to file a report with the Commission following the accounting principles prescribed in S-X and at the same time issue reports to stockholders in which entirely different accounting principles are followed, and, accordingly, most stockholders' reports conform substantially with S-X requirements.

The six statements required in the semi-annual reports to stockholders, together with comments as to additional requirements under S-X follow:

1. Balance sheet showing the aggregate value of investments. Open-end companies may substitute the statement of assets and liabilities mentioned above.
2. List of securities owned showing quantities and values thereof. Securities not exceeding 5% of the aggregate value may be grouped as miscellaneous provided they have not been held for more than one year. Regulation S-X requires also that (a) cost be stated for each item, (b) non-income producing securities be indicated by appropriate symbol, (c) bonds, preferred stocks and common stocks be listed separately with classification within each subdivision according to type of business with sub-totals, (d) any

securities subject to option be noted, (e) aggregate cost for Federal income tax purposes be stated, and (f) any value determined on any other basis than closing prices on a national securities exchange be explained. S-X also requires that securities of other investment companies if representing more than 5% of total assets, investments other than securities, and investments in affiliates be shown separately in the balance sheet with supporting schedules giving certain additional information. It should be noted that under S-X an "affiliate" in the case of an investment company includes among others any company 5% of whose voting securities are owned. If the stockholders report is to be used in the annual report to the Commission, these requirements must be met or separate security schedules filed.

3. Statement of income in which at least each category of income or expense representing more than 5% of the total income or expense is to be itemized. A quarterly report to stockholders conforming to these rules may cover only the quarter or may cover the period since the close of the last fiscal year.
4. Statement of surplus in which at least each charge or credit representing more than 5% of the total charges or credits is to be itemized. Open-end companies may substitute for this statement the statement of changes in net assets previously mentioned provided that with respect to the period for which the report is made and with respect to the next preceding three fiscal years a statement is included showing the net asset value per share at the beginning and end of each such period and the dividends declared for each such period showing the portion declared other than out of ordinary income.
5. Statement of aggregate remuneration paid for the period covered by the report to all directors and advisory board members (a) for regular compensation and (b) for special compensation; to all officers, and to each person with whom any officer or director is affiliated.
6. Statement of the aggregate dollar amounts of purchases and sales of investment securities, other than Government securities, during the period covered by the report.

In addition to the statements above which form the basis for the annual and semi-annual reports to stockholders, S-X requires two further statements in filings with the Commission:

1. Statement of realized gain or loss on investments in which the aggregate proceeds are to be shown separately for investments in securities of affiliates, investments in U. S. Government securities, investments in other securities and other investments, and in which the basis followed in determining the cost of securities sold is to be stated and if other than an average cost basis is used the gain or loss computed on such average cost basis is to be shown. Provision for income taxes is to be deducted from the realized gain. In the case of "regulated investment companies" who distribute these gains, no Federal income tax is applicable but it should be noted that even in such cases State income taxes may appropriately be allocated between ordinary income and capital gain. A tax such as New York City gross receipts tax is logically also allocable as between ordinary income and capital gain.
2. Statement of unrealized appreciation or depreciation of investments showing the balance at beginning and end of the period together with the increase or decrease. This statement as such may be omitted by a closed-end company which carries its investments at cost with market value shown parenthetically but even in such case the increase or

decrease in unrealized appreciation or depreciation must be shown.

Many companies include these two statements in their reports to stockholders. It will be observed that a company which uses the statement of changes in net assets can very easily work these two statements in as a part of that statement rather than showing them separately.

There is a technical rule in S-X that if the statements of realized gain or loss and of unrealized appreciation or depreciation are not shown on the same page as the statement of income and expense the net gain or loss and the net increase or decrease must be appended immediately following the figure of net income shown in the statement of income and expense.

Some people feel, with considerable justification, that the statements of realized and unrealized gains or appreciation should be combined into one statement since the results shown in these statements are only significant when considered in the light of each other. With such a combination it will be seen that the disclosure of realized gains on an average cost basis has little significance.

Regulation S-X, of course, also requires certain supporting schedules. Those relating to investments have been mentioned previously. In addition, where applicable, schedules are required similar to those for industrial companies covering amounts due from directors and officers, indebtedness to affiliates, reserves, funded debt and capital shares.

Accounting Principles

Accounting principles set forth in Regulation S-X of particular pertinence to investment companies are as follows:

Value of portfolio securities is to be determined by using the market value of such securities for which market quotations are readily available and the fair value as determined in good faith by the Board of Directors for other securities and assets.

Closed-end companies may reflect all assets at cost showing value parenthetically, but, if assets are reflected at cost, due consideration shall be given to evidence of probable loss and, where such evidence indicates an apparently permanent decline in underlying value and earning power, recognition thereof shall be made.

Open-end companies are required to furnish information as to number of shares sold and repurchased during an accounting period together with the respective amounts (this information can easily be worked into the statement of changes in net assets). Closed-end companies are required to furnish additional information as to securities repurchased during the period.

Appropriate provision is to be made for Federal income taxes payable or which will become payable in respect of current net income, realized gain on investments and unrealized appreciation on investments. In a footnote the company's status as to being a "regulated investment company" under the Internal Revenue Code and an indication of the principal present assumptions on which the company has relied in making or not making provision for Federal income taxes are to be stated.

This rule touches upon a possibly controversial subject, particularly as regards open-end companies. It is fairly well agreed that any companies who do not elect to be "regulated" under the Internal Revenue Code, and thus will be taxed as corporations, should provide accruals for current Federal income taxes on ordinary income and capital gains and should also provide for future taxes upon unrealized appreciation. However, it seems to be a general policy not to provide for such taxes in the case of a "regulated" company, on the theory there will be little if any tax payable for the year since substantially all the ordinary income and realized gains will be distributed to stockholders and the company will

thus have no tax to pay for the year. But there may be fallacy in this reasoning as a basis for not providing for taxes. Let us assume a company has assets of $3,000,000 including unrealized (and thus untaxed) appreciation of $300,000 at an interim date. Assume 300,000 shares outstanding. An incoming stockholder pays $10 per share for his stock (excluding the sales load). Disregarding other transactions, assume the $300,000 appreciation is immediately converted to realized gain and distributed. The new stockholder received $1 per share capital gain dividend upon which he must pay a capital gain tax of 25%. Having done that he has paid out a net amount of $9.25 per share but has an equity in assets which is worth only $9.00 per share (assuming no change in market values). Of course, as an offset against this apparent loss, the stockholder's investment continues to have a cost basis for tax purposes of $10.00 per share. He may thus recover the $.25 tax when he liquidates his investment, but there is at least a question as to whether this is sufficient ground for not providing a tax reserve as the appreciation accrues.

The following rules, prescribed in S-X, relate to income and expenses:

Income is to be divided to show separately cash dividends, non-cash dividends, cash or other dividends representing arrearages on preferred stock applicable to prior periods, interest, interest arrearages on bonds in default applicable to prior periods and other income.

Dividends may be included at the ex-dividend date—many companies accrue dividends as receivable at that date, but some merely add the dividends to the market valuation of securities and thus take the dividends into income only as received to conform to the Federal income tax rule.

Consideration is to be given to the propriety of treating as income dividends on stock acquired or disposed of during the period. Thus ordinary income might be increased at the expense of realized gains or unrealized appreciation by buying stocks just before the ex-dividend date — of course these would be taxable dividends for tax purposes.

Consideration is likewise to be given to the propriety of treating as income dividends known to have been declared out of sources other than current or accumulated earnings or dividends declared out of accumulated earnings of periods prior to the current or preceding year which are abnormal in size in relationship to the value of the stock.

Dividends received from controlled companies may be included only to the extent they are out of earnings subsequent to acquisition (or subsequent to a quasi-reorganization of the recipient company). As previously mentioned, a controlled company under the Investment Company Act is one in which 25% of the voting securities are owned.

As to any non-cash dividends received the basis on which taken into income is to be stated. An explanation is to be given as to any non-cash dividends received from a controlled company credited to income in a different amount than charged to earned surplus by the disbursing company, and the amount of the difference is to be stated.

Arrearage dividends on preferred stock may be included in income only to the extent of the stated dividend rate applied to the period during which the stock has been held adjusted to the nearest full quarter year.

Consideration is to be given to the propriety of including in income interest received on bonds which were in default when acquired and the policy in accounting for such interest shall be stated in a footnote. Note that there is an inconsistency in the rules as between preferred dividend arrears and interest arrears. The former may not be included in income except to an extent representing the period of ownership —there is no such absolute prohibition in the case of interest—the Federal income tax rule in many cases would be

diametrically opposed to these treatments.

In addition to itemizing expense categories representing more than 5% of the total expenses, there must be brought out (1) the total of management and other service fees to unaffiliated persons, (2) the same total paid to affiliated persons with the name of each affiliated person receiving over 10% of the total, the nature of the affiliation of each such person, and the amount to each such person, and (3) other expenses within the person's own organization in connection with research, selection and supervision of investments. In a note the basis and methods of computing management or service fees are to be stated and if none was incurred for the period the reason therefor.

Taxes, interest, Federal income taxes and other income taxes are to be separately shown. Income taxes applicable to realized gain on investments are to be charged thereagainst.

Recurrent costs of issuing shares (this applies to an open-end company primarily) are to be charged to expense in the period in which such costs are incurred.

In statements of surplus or the alternative statement of changes in net assets ordinary net income and realized gain on investments are to be brought in separately and the distributions to stockholders from each source are to be deducted therefrom. The dates and amounts per share of dividends paid during the period are to be shown.

In connection with showing the balance of undistributed income, open-end companies which record separately a part of the issue and repurchase price of capital shares as an adjustment on account of undivided income are to include as a separate item the difference between the amount received on new shares and the amount paid on repurchased shares. It would seem more informative to show these figures gross since under present Federal income tax rules the receipt represents paid-in surplus non-taxable while the payment represents a dividend distribution deductible in determining the tax of a "regulated" company.

Calculation of Net Asset Values

An accounting procedural problem which is common to all open-end companies is the daily valuation of assets with deduction of liabilities to arrive at a net asset value which is the basis for selling additional shares or repurchasing shares. These valuations are generally made twice a day, once just after the close of the New York Stock Exchange which fixes the price for shares until 1:00 P.M. the next day and again based on noon prices which establishes the price for shares from 1:00 P.M. till the close of the day. Under rules of the National Association of Securities Dealers, the second pricing at noon must be made or no sales of stock may be made between 1:00 and 4:00 P.M. These rules have the effect of law since they are recognized under provisions of Section 22 of the Investment Company Act. The prices generally used for securities traded on an exchange are the last sale price or, if there have been no sales since the last price determination, the mean between the bid and asked prices. The mean between bid and asked prices is also used for over-the-counter securities. In arriving at net asset value per share, it is necessary to provide for the deduction of accruing liabilities. These are sometimes adjusted daily but frequently are only adjusted once a week or even bi-weekly on the theory that any adjustment not made would have less than 1¢ effect on the final price. It is also necessary to provide for accruing dividends on stocks owned on the day they are first quoted ex-dividend either as a receivable or as an addition to the quoted market price. Likewise, interest on bonds owned must be accrued although this is frequently not very material and does not require accruing at more frequent intervals than used for expense accruals.

Federal Income Taxes

The subject of accounting for investment companies is not complete without some comment as to their status for purposes of Federal income taxation to which references have heretofore been made.

Such companies fall broadly in two classes — those who are eligible and elect to be taxed as "regulated investment companies" under Sections 361 and 362 of the Internal Revenue Code and all others. It might be appropriate also to mention common trust funds established by banks for the pooling of investments of their various individual trusts. They operate in a manner similar to open-end investment companies but are not subject to the Investment Company Act (although they are subject to state banking laws and to regulation under the Federal Reserve System). These common trust funds if of an eligible nature are treated for tax purposes, under Section 169 of the Internal Revenue Code, as though they were partnerships, a new partnership being in effect between each date at which participating trusts are admitted or withdrawn.

Investment companies that cannot or do not elect to be "regulated" are taxed as ordinary corporations. One peculiarity applicable to these companies who cannot or do not elect to be taxed as "regulated" companies might be mentioned. Where, as is usually the case, the main source of income is domestic dividends, these companies can reduce their over-all tax by having a certain amount of long-term capital gains. This stems from the fact that the dividends received credit is limited to the amount of net income, and long-term capital gain is included in net income although pulled out in an alternative calculation and taxed at 25%. Thus, assuming no other ordinary income than domestic dividends and assuming taxable net income in excess of the surtax exemption of $25,000, long-term capital gains equivalent to allowable deductions will save Federal income tax under the Revenue Act of 1950 at the rate of 13.25% thereof (85% of 45% less 25%). This situation creates a problem in applying the theory that Federal income taxes should be provided against unrealized appreciation since from year to year in many cases a part of the unrealized appreciation can be realized at a tax saving rather than at a tax cost.

Another point of general application is that dividends do not represent income until the date received so that there is frequently an adjustment to be made for dividends treated in the accounts as receivable at the beginning and at the end of the year.

To be eligible to elect to be taxed as a "regulated investment company" certain requirements must be met. These are:

1. The company must be registered at all times during the taxable year under the Investment Company Act of 1940 (or must be a bank common trust fund not meeting the requirements of Section 169).
2. At least 90% of gross income must be derived from dividends, interest and gains on sale of investments with less than 30% derived from sales of investments held for less than three months.
3. Diversification of investments determined at the close of each quarter of the taxable year must be met as follows (it will be noted that this diversification test is patterned after the diversification test in the Investment Company Act but is materially different in some respects):
   - (a) At least 50% of the value of total assets must consist of cash and cash items and securities, the investment in the securities included in the 50% test being limited so that not more than 5% of total assets are invested in the securities of any one issuer and not

more than 10% of the voting securities of any one issuer are owned (it not being required to include government securities or securities of other investment companies in either the 5% or 10% test).

(b) Not more than 25% of the value of total assets is invested in securities of any one issuer (excluding government securities and other regulated investment companies) or of two or more issuers which the taxpayer controls (owns directly, or through controlled companies, 20% of the voting securities) *and* which are determined to be engaged in the same or similar trades or businesses or related trades or businesses.

There is also a requirement in Regulations 111 that permanent records be maintained by a regulated investment company for the purpose of determining whether it is a personal holding company. These records must show the maximum number of shares being considered as actually or constructively owned by each of the owners at any time during the last half of the taxable year. Statements giving this information must be demanded not later than thirty days after the close of the taxable year

1. from each record holder of 5% or more in the case of a company having 2,000 owners on any dividend record date
2. from each holder of 1% or more in the case of a corporation having more than 200 owners but less than 2,000
3. from each holder of ½ of 1% or more of its stock in the case of a corporation having 200 or less owners.

The election to be a "regulated investment company" is made merely by computing income as a regulated investment company in the return but once made is irrevocable for the current and all succeeding taxable years.

Having met these qualifications and elected, the company must then distribute during the taxable year as taxable dividends (other than "capital gain dividends") not less than 90% of its taxable net income (excluding net long-term *and* net short-term capital gains). The Revenue Act of 1950 has broadened this provision so that dividends declared up to the date the return is due to be filed may by election be treated as a distribution of earnings of the taxable year. It should be noted that it is not necessary to include short-term gains in income in determining whether 90% thereof has been distributed in any year, although they are includible in the income to be taxed if not distributed. A "capital gain dividend" is that portion of any dividend or dividends which is designated as such by the company in a written notice mailed to shareholders within thirty days after the close of the taxable year but limited to the excess of net long-term capital gain over net short-term capital loss.

Any net income (excluding the excess of net long-term capital gains over net short-term capital losses) to the extent not distributed is taxed at the rates applicable to corporations generally and the excess of net long-term capital gains over net short-term capital losses to the extent not distributed in the form of designated capital gain dividends is taxed at 25%.

Net operating loss carry-overs are not allowable deductions in the case of a "regulated" company but capital loss carry-overs are allowed and become short-term losses in the various calculations.

Another peculiarity is that earnings of the current year are not to be reduced by any amount which is not allowable as a deduction in computing net income for tax purposes. This may be an important consideration, since if a company has substantial capital losses and does not elect to be taxed as a

"regulated" company its dividends may be partially or wholly non-taxable in the hands of its stockholders whereas if the election were made to be a "regulated" company, the dividends would become taxable since the non-deductible capital losses cannot be considered in determining their taxability.

In connection with taxation as a regulated investment company, a minor question arises which has not been tackled or solved by many of the open-end companies. As previously mentioned at the time new shares are issued a portion of the sales price is frequently segregated as an "equalization" account. This is equivalent to the per share amount of undistributed ordinary income (including the balance in the equalization account itself). Conversely at the time of redemptions a portion of the redemption price is similarly segregated and charged against the equalization account. The purpose of this operation is to prevent dilution of the dividend rate when the fund is growing. For Federal income tax purposes equalization amounts paid in are not includible in net income. On the other hand amounts paid out for equalization purposes may, following a recent Tax Court decision* in which the Commissioner has acquiesced, be considered as dividends paid and thus used as part of the dividend credit to be deducted from net income before applying the tax.

Many open-end companies distribute as ordinary dividends the sum of ordinary income plus the net credit in the equalization account, but they do not attempt to make any distinction as between the portion paid from income and the portion paid from equalization account in notifying stockholders as to the taxability of dividends in their hands. Thus stockholders presumably must include the total of such dividends in their net income as fully taxable. A problem arises even if an attempt were made to allocate the non-taxable portion to stockholders since it presumably would have to be allocated to all stockholders ratably based on the total year's dividends even though the non-taxable portion represents in effect a return of capital investment to those who paid in the equalization amounts with no part belonging to those who held stock unchanged throughout the year.

In connection with income taxes open-end companies have one further point to observe. In order that no question may be raised as to a taxable gain on dealing in their own shares, their own shares repurchased are cancelled rather than being resold, the authorized but unissued stock being used for additional sales.

* National Securities Series—Industrial Stocks Series et al., 13 T.C. 884.

New York State Tax Clinic

Conducted by Benjamin Harrow, C.P.A.

Estate Tax—Contemplation of Death

The new Revenue Act of 1950 modifies somewhat the familiar provision subjecting to the estate tax gifts made in contemplation of death. Until the present change in the law, any gift made within two years from the date of death was presumed to be in contemplation of death, but the Treasury could carry the burden of proving that any gift made at any time during the life of a decedent was made in contemplation of death. The new law removes from the scope of contemplation of death all gifts made more than three years prior to death, but the estate has the burden of proving that a gift made within the three year period was not in contemplation of death.

This is a desirable change since the administration of the old provision has been difficult and costly both to the government and to estates.

The government won a recent interesting contemplation of death case in the Tax Court.[1] The decedent had set up an *inter vivos* trust. He was 72 years old at the time. He also had his attorney prepare a will at the same time. It was alleged that the motive for setting up the trust was the saving of income tax. The income of the trust was to be accumulated during the lifetime of the decedent and upon his death was to be distributed to his children. The principal of the trust was subject to a life estate in the wife, after which it too was to be distributed to the children. The decedent died eight years after the trust had been set up.

The court held that the trust clearly showed that the dominant purpose for the trust was to provide for beneficiaries after death by a substitute for testamentary disposition. A transfer may be in contemplation of death even though not indorsed by fear of imminent death. All the provisions of the trust dealt with what should be done under various contingencies after the death of the decedent. The court held that there was evidence that the decedent had in mind the avoidance of some income taxes, a motive connected with life rather than death, but said the court,

> "a disposition which is in effect a testamentary disposition is made in contemplation of death even though, to save taxes, it may be put in the form of an inter vivos trust rather than as a part of a will."

The tax saving motive was deemed insignificant compared with the dominant motive to dispose of a large portion of his property through a device which

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[1] *Estate of Jacob Gidivitz., dec'd., et al.* v. *Comm.*, 14 T. C. 144; June 23, 1950.

was a substitute for a testamentary disposition. The age of the decedent and the condition of his health at the time of the transfer were minor factors compared with the terms of the trust.

Reporting Federal Changes to the State Tax Commission

Effective July 1, 1949 the New York State Income Tax Law was amended (Sec. 367.2) to require a taxpayer to report federal income tax changes made by the Commissioner of Internal Revenue or other competent Federal authority. Notification must be made within 90 days after a final determination. At the time of notification the taxpayer may question the accuracy of the change in net income and state wherein the change is erroneous.

It is advisable for a taxpayer to report such changes, since the federal government reports these to the State Tax Commission in any event, and the taxpayer gains nothing in delaying the assessment of an additional state tax. As a matter of fact, the Tax Commission is in a position to assert penalties and interest, which it normally does not do, where there is a mere understatement in income without negligence or fraud.

The amended law and regulations require the filing of an amended return with the State Tax Commission within 90 days after one is filed with the Treasury Department. The Tax Commission has one year after the receipt of a notification of a change in federal net income, or the filing of an amended return within which to issue an assessment for any tax due. There is no limitation where there has not been a proper notification nor a filing of an amended return. A further penalty for non-notification or non-filing of an amended return is that no refund will be made if one is due.

The regulations (Article 571(a)) provide that the Tax Commission may conduct its own independent investigation in determining the correctness of any modification in net income by the Commissioner of Internal Revenue.

A taxpayer may be uncertain as to just when a proposed change in federal net income should be reported. The law requires notification after a final determination and the regulations make clear just what this means. It is "an irrevocable determination or adjustment of a taxpayer's Federal tax liability from which there exists no further right of appeal either administrative or judicial." As examples of a final determination, the regulations cite a closing agreement made under Section 3760 of the I.R.C.; an allowance of a refund by the Commissioner. The 90-day deficiency notice under Section 272(a) of the I.R.C. is a final determination, unless a petition is filed in the Tax Court. In that case, the judgment of the court of last resort affirming the deficiency or redetermining it is the final determination.

Acceleration of Payments

The federal Revenue Act of 1950 accelerates installment payments for corporations, trusts, and non-resident aliens. The latter will be required to pay the tax in full when the return is due. Trusts will also be required to pay the tax in full when the return is due. However, the new revenue act gives the fiduciary of the trust an additional month within which to file the return and pay the tax. Estates will continue to pay the tax in four quarterly installments, but they also may have the benefit of the additional month within which to file the return. Corporations will gradually be placed on a two installment basis of paying the tax, instead of four. It will take five years to accomplish this. Each year the first two installments will be increased by five percentage points, with a corresponding reduction in the third and fourth installments. In this way, the first two installments will be increased to 50% each in the fifth year.

This idea of accelerating payments will probably be utilized by states. Already the Massachusetts Legislature, which adjourned on August 19, 1950, has amended its Personal Income

Tax Law to provide for payment of the tax in full at the time the return is filed. This provision becomes effective January 1, 1951.

Recovery of Taxes Against Non-residents

If a non-resident of a state owes a tax, how does the state proceed against him to enforce payment? Basically, the state must obtain jurisdiction over the person of the non-resident, but if he is not personally present within the state and if he has not in some way submitted himself to the jurisdiction of the state, the state has no direct method of pursuing the non-resident, obtaining a judgment, and levying execution. The usual procedure is to obtain a judgment in the state where the non-resident has become liable for the tax (all states have adequate laws for obtaining jurisdiction to sustain such a judgment in its state.) Thereafter, the taxing state must bring an action on the judgment in the non-resident's home state.

Another troublesome situation is the case of a citizen of one state who becomes liable for a tax and then leaves the state. There is a general rule among the states that the courts of one state cannot be used to enforce the tax laws of another state. The fiscal needs of the states have made necessary a new approach to this problem. In a recent issue of the New York State Tax Clinic,[2] we called attention to the procedure now sanctioned in a number of states giving the taxing state access to the courts of other states to enforce claims for taxes. Kentucky has now opened her courts to other states to enforce their tax claims against residents or ex-residents of the taxing states, providing the taxing state extends a like privilege to the State of Kentucky. However, the Kentucky courts will not enforce a tax claim that is unconstitutional under the constitution of the taxing state or the Constitution of the United States. To determine the constitutionality of the tax law, Kentucky courts will follow the construction of state tax laws, as determined by the highest court of the state levying the tax.

Unincorporated Business Tax— Sale or Liquidation of Business

A taxpayer is subject to this tax if he is carrying on a business. That means that the taxpayer is engaged in some business activity with regularity and continuity. Suppose a taxpayer engaged in some unincorporated business activity decides to cease operations and proceeds to sell the business or liquidate it himself. Does this activity come within the scope of the unincorporated business tax law? In a sense liquidation is the antithesis of carrying on a business, since the purpose is to cease carrying on a business. However, where a taxpayer sells or liquidates his business himself, the Tax Commission takes the view that the going out of business may be considered as proximately related to the carrying on of the business, and considers the activity as coming within the scope of the Unincorporated Business Tax Law.

Is a trustee, receiver, assignee, or other legal representative of a bankrupt or otherwise financially embarrassed unincorporated business subject to the unincorporated business tax? The regulations state that the test is whether the legal representative is carrying on the business in substantially the same form in which it was conducted by the former owner, or whether his function is merely to liquidate the business, i.e., sell the assets, distribute the proceeds, and wind up the affairs of the business. If the former, the legal representative will be considered to be carrying on an unincorporated business; if the latter, he would not be so engaged.

The outright sale of a business at a profit would also be considered as coming within the scope of the Unincorporated Business Tax Law. Several of our members have been confronted with this situation recently and have

[2] May, 1950; p. 311.

been puzzled by this and related problems. For example, take the case of a taxpayer who has been operating a bar and grill for a number of years and then decides to sell the business at a price in excess of the book value of the inventory and fixtures, the difference being essentially goodwill. The entire selling price would be subject to the unincorporated business tax.

There is a collateral issue involved in the treatment of goodwill as a capital asset. The Tax Commission recognizes goodwill as a capital asset, but it will not allow capital gain treatment for the portion of the selling price attributable to goodwill, unless the sales contract specifically breaks down the selling price into the portion attributable to the assets disposed of and the portion paid for the goodwill. If the selling price covers the entire business, the entire payment is subject to income tax and unincorporated business tax as ordinary income. Even if the sale of goodwill is recognized as a capital gain, it would still be subject to the unincorporated business tax.

Sale of a Partnership Interest as Capital Gain

A recent Circuit Court opinion[3] dealt with the problem of the nature of a sale of a partnership interest under the federal income tax law. One partner in a law firm sold his partnership interest to another partner. The principle assets of the partnership consisted of receivables for legal services rendered. In the normal course of its business, the collection of the receivables would be ordinary income. The Tax Court held that the money received by the retiring partner in excess of his basis for his partnership interest was ordinary income, but the Circuit Court reversed, on the ground that the sale of a partnership interest is the sale of a capital interest with a resulting capital gain.

Sale of Copyrights, Books, and Artistic Works

Under the federal law, and state law as well, a taxpayer will naturally try to get capital gain treatment for income. Such gains under the state law are taxed at one-half the rates applicable to ordinary income. The non-professional writer, under the federal law in effect until September 23, 1950 (when the Revenue Act of 1950 was passed) could sell his artistic creation outright and report the income as a capital gain. The new law closes this "loophole" by providing that if the property sold by him is the result of personal efforts created by him it will not come within the definition of a capital asset. This provision would apply also to a radio program. If the sale is made by a transferee who must use the basis of the taxpayer who created the work, the income to the transferee would also be ordinary income and not capital gain. A transfer by a gift would thus not succeed in avoiding the new provision in the law. In the case of an installment sale that had been made prior to September 23, 1950, payment after this date will be treated as ordinary income. To prevent the creator of the work from using the property in a business and then claiming capital gain treatment for the income under Section 117-j, that section has also been amended. Even a transfer of the property to a corporation, followed by a sale of the stock, may not help the taxpayer under the new provision relating to collapsible corporations. Property received by inheritance would probably not come within the new provisions.

Powers of Tax Commission—Arbitrary Assessments

An interesting decision was handed down recently by the New York Supreme Court.[4] Section 373 of the Tax Law gives the Tax Commission the power to revise an income tax return.

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[3] *Max Swiren* v. *Commissioner*, CCA-7; July 14, 1950.

[4] *Brown* v. *State Tax Commission*, 99 N. Y. S. (2d) 173, Onondaga County; July 5, 1950.

It authorizes the Tax Commission to make an estimate of the taxable income of a taxpayer if the return is incorrect in any essential respect on the basis of any information in its possession. However, it must do this within three years after the return is filed.

In the instant case, the taxpayer had filed an income tax return for the year 1946 on or about April 15, 1947. Prior to April 15, 1950, at which time the three-year statute would have run, the Tax Commission requested the taxpayer to consent to an extension of the time limitation to 1952. Apparently, the Tax Commission wanted to audit the return, but could not conveniently do so before April 15, 1950. The taxpayer refused to extend the time. The Tax Commission thereupon arbitrarily added $5,553.23 to taxpayer's income and assessed a tax on that basis. Apparently that was done just to extend the time within which the Commission could look fully into the correctness of the return as filed.

Normally, the taxpayer could, under Section 374, ask for a review of the assessment by filing an application for revision on form 113 within one year from the date of the assessment or within two years from the date on which the return is filed, whichever date is later. If the application is denied, the taxpayer, within 90 days of the notice of such denial, could demand a formal hearing. Thereafter, the taxpayer could request a review in the courts of the determination based upon the formal hearing (Section 375). This taxpayer however brought an action in the Supreme Court for a declaratory judgment and for an injunction. The Tax Commission argued for a dismissal of the action on the ground that the taxpayer had an adequate, complete, and exclusive remedy as provided by sections 374 and 375.

The first question the court considered was whether the Tax Commission could make an arbitrary assessment for the sole purpose of extending the three-year statutory period. The court's answer was that the legislature never intended to permit the Tax Commission to make an arbitrary assessment without any basis solely for the purpose of getting an extension of time within which to make a correct assessment. In spite of the wide discretionary power granted to the Commission, it should not be allowed to circumvent the provision setting down the limitation period of three years. The Court therefore held that the action of the Tax Commission was unjustified, without authority and arbitrary, and therefore the assessment was invalid and void.

The next question was whether a declaratory judgment was the proper and appropriate remedy. Said the Court,

> "The general purpose of declaratory judgment is to quiet and stabilize uncertain or disputed jural relations either as to present or prospective obligations, and no limitation has been placed or attempted to be placed upon its use."

The Court pointed out that no judicial determination had ever been made on the question of whether an additional assessment could be made under Section 373 to circumvent the statute of limitations. This involves a question of law which would serve the purpose of "quieting or stabilizing an uncertain or disputed jural relation." That is the purpose of a declaratory judgment. The court cited a number of cases justifying its holding that the exclusive procedure provision in the law does not apply unless the Commission acts within the authority granted by Section 373, that is, it must have some real basis for the arbitrary assessment. This may be a far reaching decision.

Secrecy of Returns—Franchise Tax

Our attention was recently called to the case of a corporation that did not wish to report the rental paid on its properties, for the reason that it did not wish this information to become public. Apparently, the taxpayer was not fully aware of the provision in Sec. 211 (8) of Article 9A, which is quite a vigorous prohibition against divulging information furnished to the Tax Commission.

It is unlawful for any employee who is permitted to inspect a report to divulge any information contained in such report. Any officer charged with the custody of such report shall not produce the report in any court action unless the State is a party in the action. If the report is directly involved in any action, the court may require the production of so much of the report as is pertinent to the action and no more. The penalty for disclosing information is a fine not exceeding $1,000.00 or imprisonment for one year, or both, at the discretion of the court. If the offender is an officer or employee of the state, he is subject to dismissal from office and he may not thereafter hold any public office in the state for a period of five years.

The provision for maintaining secrecy of reports does not prohibit the delivery of a copy of the report to a duly-authorized representative of the corporation. Nor is the publication of delinquent lists showing the names of taxpayers who have failed to pay their taxes at any time prohibited. The Attorney General, or other legal representatives of the State, may inspect reports of any corporation that may bring an action to review a tax. The comptroller or any designated officer of the Department of Audit and Control may inspect a return for the purpose of auditing a claim for refund of any tax paid by the corporation.

It is true that information is exchanged with taxing officials of other states and with the federal government. Sec. 211 (8) covers this exception to the secrecy requirements, but the Tax Commission may exchange such information as it considers proper and only if the other state or federal government grants like privileges to New York. Even in the case of exchange of information, there is a provision that such information is to be used for tax purposes only. By an amendment to this section effective April 10, 1945, an authorized official of a municipality may receive information from the Tax Commission giving the municipality the name and address of a corporation subject to tax under Art. 9A and information in relation to the location and value of tangible personal property shown on the tax report and the amount of tax distributable to municipalities.

In a case decided as long ago as 1925, the Court said that a judicial order to make known the contents of a report will not be made except when the integrity of the report itself is attacked as the main issue and not when it is merely a collateral issue.[5] As recently as 1945, the court in another case[6] held that it does not have the power to order the production of other tax returns of other corporations to sustain the contention of the plaintiff that a predecessor was assessed a franchise tax at a higher rate than other financial institutions.

Deduction for Traveling and Entertaining Expenses

Ordinary and necessary expenses incurred in a business or profession or in connection with the production of income are deductible. Traveling and entertaining expenses clearly come within this provision in the law. To obtain the deduction, the taxpayer must be prepared to prove that there has been an actual expenditure for traveling and entertaining. This usually presents a difficulty, since taxpayers do not as a rule keep a detailed record to evidence such expenditures. This has resulted in the common practice of taking a deduction for such expenses on an estimated basis. Until a few years ago the Treasury Department, and the Tax Commission as well, could disallow in its entirety a deduction based upon an estimate. However in *Cohan* v. *Commissioner*,[7] the Tax Court ap-

5 *People* v. *Isaac G. Johnson & Co.*, 213 App. Div. 402.
6 In re *Manufacturers Trust Co., et al.* 269 App. Div. 108, affd., 296 N. Y. 549 (1946).
7 39 F (2d) 540.

proved a deduction not supported by evidence of the actual expenditure where the court was convinced that expenditures in these categories had been made.

Another difficulty in establishing the propriety of a deduction for traveling and entertaining expenses is the possible overlapping of business and personal expenditures. An expenditure in the latter category is, of course, generally not deductible. The question for the taxpayer is resolved more easily than it is for the tax administrator. It is in this area that disputes arise most frequently. Usually they are resolved on a compromise basis.[8] In a period of high tax rates, taxpayers are likely to estimate traveling and entertaining expenses at too high an amount for tax officials to accept without argument and, since an attack on these deductions is likely to result in considerable additional revenue, the tax official has a veritable field day when he questions this deduction.

Apparently, in auditing income tax returns, the Tax Commission has recently centered its emphasis on this deduction. Many of us are familiar with the full page letter signed by the assistant director of the Income Tax Bureau, Morton T. Valley, able conservator of the State's revenues, containing a request for rather detailed information in substantiation of traveling and entertaining expenses. If such expenditures have been lumped in one amount, our director politely asks for a segregation showing the amount applicable to traveling and, correspondingly, the amount applicable for entertaining expenses. Then he asks to be informed as to the territory covered in incurring traveling expense and the approximate number of trips made during the year. If the taxpayer is a member of a partnership or an officer and employee of a closed corporation, he is asked to state the reasons why he was not reimbursed for all the ordinary and necessary expenses incurred by him.

With respect to entertaining expenses, the Income Tax Bureau asks for the nature of the expenses and the reasons why the taxpayer considers them to be a proper expense in connection with the production of income.

The Income Tax Bureau keeps reminding taxpayers of the requirement in the law that federal changes must be reported to the Tax Commission within 90 days after a final determination. The Commission requests copies of changes made by the federal internal revenue department for review. If the federal government has disallowed any traveling and entertaining expenses, the taxpayer may be certain that the Tax Commission will make a similar disallowance. It should be noted, however, that the Commission is not limited in any way by what the federal government has done. It is free to make its own determination.

Unemployment Insurance—Failure to Make Timely Payment of Contributions

A recent Appeal Board decision highlights the severity of the statute in exacting interest on the failure to make quarterly contributions strictly within the time fixed in the statute. In the case at issue, contributions for the second quarter of 1948 were due no later than July 31, 1948. Payment by the employer was made on Monday, August 2, 1948. The Commissioner assessed the employer for interest at the rate of ¾ of 1% for the entire month of August, in accordance with Section 570.4 of the Labor Law.

The employer had called the Division Office at Albany on Tuesday, July 27, and asked whether or not the office would be open on Saturday. He was informed that the office would be closed. He then asked if it would be satisfactory to deliver the report on Monday, August 2, and received an affirmative

[8] See note 7.

reply. The referee who first heard the case had overruled the assessment for interest on the ground that the employer had until midnight of Saturday, July 31, to mail the check and, if he had done so, the check would not have been received before August 2. The referee held that in effect the provisions of Section 570.4 were substantially compiled with.

The Commissioner appealed the decision and contended that the assessment for interest was mandatory and could not be waived and that the assurance which an employee of the Division gave to the employer could not estop the State from imposing and collecting any interest due. The Appeals Board sustained the Commissioner. Interest cannot be waived. A failure to comply strictly with the requirements for paying contributions requires the assessment of interest. This is a mandatory requirement.

This case illustrates the harshness of the mandatory assessment of interest. In the interests of the overburdened taxpayer the Legislature should amend this provision in the law to give the Commissioner the equitable power to waive interest in meritorious cases. In fact the initiative for this amendment should come from the Commissioner himself.

Some Problems of Tax Law Administration in New York

(Continued from page 710)

Lowered Cost of Statutory Compliance

Growing use — and usefulness — of these facilities is paralleled in New York by closer attention to the cost of tax compliance. There is no question but that business, small and large, has over the stretch of years seen its tax reporting job grow more and more complex, exacting—and costly. Low administrative costs have been a matter of record and a matter of pride in our department. But until recent years, cost of compliance by the taxpayer has not always been a matter of sufficient concern or attention. Evidences of steps toward easier compliance with State tax laws are seen now in simplification of forms—such as our new State income tax form — and in developments toward uniformity, wherever feasible.

No one is ever going to like to pay taxes. As we see it, the tax administrator's job is to make compliance as easy and convenient and inexpensive as possible. Thus our major objectives lie in the direction of simplification, uniformity and inter-governmental coordination. Finally, and perhaps most importantly, the administrator must be conscious, always, of the guaranteed, individual rights of the taxpayer.

That is how we are trying to administer the taxes of New York State.

Accounting at the S.E.C.

Conducted by Louis H. Rappaport, C.P.A.

More About Bulletin No. 32

In our previous issue we discussed the views of the SEC with respect to Accounting Research Bulletin No. 32 and how the bulletin has been applied in documents filed with the SEC. Below are two more cases on the same subject.

Case No. 3: Loss on Sale of Fixed Assets

In its original filing on Form 10-K, Company X reported a net loss of $918,000 for the year ended June 30, 1949. (In the preceding fiscal year the company reported net income of $2,800,000.) Earned surplus for the year ended June 30, 1949 showed the following:

Debits:	
Provision for possible loss on liquidation of certain fixed assets	$250,000
Net adjustments in respect of federal income taxes of prior years	36,000
Total earned surplus debits	$286,000
Credits:	
Profit on sale of fixed assets, net	$11,000
Fixed assets capitalized and depreciation disallowed by revenue agent	41,000
Reversal of reserves provided in prior years no longer required and collection of claims applicable to prior years	36,000
Total earned surplus credits	$88,000

The certifying accountants issued a conventional certificate covering the above income and earned surplus statements.

Apparently the SEC took exception to the inclusion in earned surplus of the items aggregating a net debit of $198,000, and the income and earned surplus statements were subsequently amended by including in the income statement the above-noted surplus items. The revised income statement concludes as follows:

Net loss for the year before special charges and special credits		$ 918,000
Special charges:		
Net adjustments in respect of federal income taxes of prior years	$ 36,000	
Provision for possible loss on liquidation of certain fixed assets	250,000	286,000
		$1,204,000
Special credits:		
Profit on sale of fixed assets, net	$ 11,000	
Fixed assets capitalized and depreciation disallowed by revenue agent	41,000	
Reversal of reserves provided in prior years no longer required and collection of claims applicable to prior years	36,000	88,000
Net loss for the year transferred to earned surplus		$1,116,000

Louis H. Rappaport, C.P.A., has been a member of the Society since 1933. He is a partner in the firm of Lybrand, Ross Bros. & Montgomery, C.P.A's., and is also a member of the American Institute of Accountants and of the American Accounting Association.

The reader may be interested to know what the certifying accountant said about the amended statement. The accountant did not issue a certificate in the usual sense but signed a consent which reads as follows:

> We hereby consent to the use of our report dated September 15, 1949, originally

filed with the annual report on Form 10-K for the year ended June 30, 1949, with the Securities and Exchange Commission, in connection with the amended financial statement, including the notes thereto, filed herewith.

Case No. 4: Loss on Disposal of Assets at Closed Plants

A recent prospectus discloses an income statement for the year ended June 30, 1949, reading in part as follows:

Loss before income taxes		$1,715,000
Provision for income taxes:		
Estimated refunds of federal income tax due to carry-back of net operating losses	$777,000	
Less estimated refund of federal income tax applicable to loss on disposal of assets at closed plants	174,000	603,000
Net loss before loss on disposal of assets at closed plants		$1,112,000
Loss on disposal of assets at closed plants less estimated refund of federal income taxes of $174,000 applicable thereto, shown above		285,000
Net loss		$1,397,000

One of the notes to the financial statements reads in part as follows:

During the year ended June 30, 1949, the company discontinued manufacturing operations at its .... and .... plants, and except for land and buildings at ...., and machinery and equipment transferred to active plants, disposed of the fixed assets thereof at a loss. The amount of this loss, $459,000, less applicable portion of estimated income tax credit of $174,000, or a net amount of $285,000, was charged to earned surplus by the company and was so reflected in its annual report to its stockholders. It is the opinion of the company that such treatment of this item was proper, but at the request of the Securities and Exchange Commission, the company is now treating this loss as a charge to profit and loss for the year ended June 30, 1949.

The opinion of the certifying accountants contains the usual first paragraph as to scope of examination and continues as follows:

The loss on disposal of assets at closed plants as explained in Note — of the Notes to Financial Statements in our opinion should be charged to earned surplus rather than to profit and loss for the year ended June 30, 1949.

In our opinion, with the explanation in the preceding paragraph, the accompanying financial statements present fairly the financial position . . . and the results of its operations . . . in conformity with generally accepted accounting principles applied on a consistent basis.

AN ADIRONDACK VIEW

For Years we have all been sending fancy cards to our friends at this time of year. We do this to WISH them a merry Christmas and a happy New Year. And the slogan of the Christmas season is "peace on earth, good will toward men."

It looks as tho' our signals are mixed, or the wires crossed, or the columns mis-added —or something.

In the first place, we have "peace" and "good will" transposed. We need to put "good will toward men" first; then "peace on earth" follows, just like day follows night. And the place to get this good will stuff really going is first in our own families, our churches, our lodges, our clubs, and our offices.

In the second place, perhaps we better replace this WISHING business during the month of December. How can Christmas be merry or the New Year happy when war lurks among the clouds, ready to drop on us, and other peoples, at the slightest international slip? Perhaps our Christmas and New Year's cards should read— "Seasons greetings and hopes that YOU are scratching your head and doing something —instead of wishing—about good will to men and the resulting peace on earth."

LEONARD HOUGHTON, CPA
of the Adirondack "Chapter"

The Shoptalkers

Conducted by LEWIS GLUICK, C.P.A.

The Shoptalker Talks to Students —and their Teachers.

MORE years ago than he likes to think of, the senior partner of the firm by which he was then employed, handed the writer a file and told him to go out and make the regular annual audit. "Be careful," he said, "last year we uncovered quite a defalcation. There's been a shakeup, but don't run away with the idea that lightning never strikes twice in the same place." So the Shoptalker made the audit; it was signed by the big boss, and the report contained this sentence. "We are pleased to report that your books and records were in far better condition than in the previous year."

The report was hardly delivered before the client was burning up the wires. He was very much dissatisfied with that sentence. What he wanted and *demanded* was a certificate of perfection which, of course, could not be granted. However, he was mollified with an additional sentence thus: "Minor clerical errors were corrected during the course of the audit."

The Shoptalker cites this as an example that perfection is not to be attained, on this earth, anyhow. Acknowledging this, he hopes that the criticism he is about to make will be accepted as intended, constructively.

LEWIS GLUICK, C.P.A., who has been a member of our Society since 1924, has resumed the practice of accountancy in the East.

Mr. Gluick, who had been writing under the name of The Shoptalker in other magazines since 1928, recently brought his group of Shoptalkers to our columns. We would welcome your acceptance of his invitation to participate in the discussions.

The Students' Departments of two professional magazines are doing a mighty fine job, and improving each year. They are not yet perfect. They concentrate too heavily on solutions to examination problems. By so doing, they help thousands of students, not to speak of their circulation managers. They do not, however, give students some of the things they want, and herewith the Shoptalker attempts to note some of the deficiencies.

Late this past summer he had occasion to talk to a group of men who were studying accounting at night. They were a very mixed group. Three of them were young mechanics; union men getting high pay. "Why," the Shoptalker inquired, "were they studying accounting? Few accountants could earn the wages they were already earning." Every one of them replied that some day he hoped to operate his own business; be a painting or electrical contractor, or so forth. And he wanted to be able to understand, even if not actually keep, his accounts. Another was a man at least as old as the Shoptalker. Why was *he* now taking intermediate accounting? The answer was frank. This grayhead had once owned a prosperous business. Through failure to keep in touch with his bookkeeper, to understand the figures the bookkeeper did furnish, or to employ an independent auditor, he had become insolvent. There were other factors, of course. It had taken this man years and years to pay off all his debts and amass new capital. Now he was about ready to start anew; but *this* time he was going to *know* what went on. Three other young men and one middle-aged man were

bent on becoming public accountants, and one, who had finished three semesters with high grades, expressed bitter disappointment that he had been unable to land a job with a C.P.A. Parenthetically, it may be noted that he has since obtained a job. To all of this group the Students' Departments meant little or nothing. They had questions which neither the magazines, nor their regular instructor could answer. The Shoptalker overstayed his allotted time in an attempt to answer. He talked strictly "off the cuff," but since the men all expressed satisfaction, he is immodest enough to have reduced his remarks, much condensed, to print, in the hope that others will also derive benefit from them.

The study of modern accountancy originated almost entirely in preparation for the C.P.A. or Civil Service examinations. It is too much slanted that way today. The opportunities for the use of accounting knowledge in other fields is almost overlooked (except by some correspondence schools) and sometimes ignored. Yet the money-making possibilities in so-called "private" accounting are tremendous. To point this up, the Shoptalker related this incident from his practice.

Just a few months after the "perfection" episode related above, the Shoptalker made an examination of a factory, which had fallen upon bad times in the early thirties. The chief supplier of raw materials was unwilling to lose a good customer, and the banks were equally reluctant to invoke bankruptcy. So a reorganization was agreed upon. Out of it came this situation, which seemed bizarre to some of those concerned. The creditors insisted on a certain Mr. Eff, who had been merely a vice president in charge of plant, becoming president. He was the youngest of the former officers, and a very minor stockholder. Why did they do this? Because, during his college days this man had taken an elementary course in accounting, and had retained most of what he had learned. He was the only man in the old regime who could read a balance sheet, make and interpret a budget and, when he met the bankers, talk their language. And the creditors saw to it that he got a salary commensurate with his responsibility rather than his title. Accounting had paid off.

The opportunities for accountancy-trained men today may not be as great as they were twenty years ago, but they certainly are in existence, and not too hard to find. There is an over-supply of juniors and would-be juniors in public accounting. Some of them are well educated and really competent. There are just too many of them for the available jobs. Yet they have been so imbued with public accounting concepts that they are loathe to take, or even to seek, jobs in private accounting.

The Shoptalker cannot recall any time, except between 1942 and 1945, when there was not more or less of a surplus of juniors. How it reached its present proportions is not well understood, even by the men themselves. The Shoptalker thinks he has the explanation of the major factor. It is the G. I. Bill of Rights. Tens of thousands of Veterans have taken, and are still taking, courses in accounting and/or business administration. Why is accounting the favorite subject? This is the Shoptalker's diagnosis, for what it is worth.

During the war the armed forces were heavily burdened with red tape, otherwise known as "paper work." Happy was the company commander who found among his men even one man who had had a good education or experience in accounting. Ofttimes over the soldier's vehement protests, the pfc would suddenly find himself a non-com doing clerical duty. He often felt bad about being called "waffle-seat," but this was tempered by the fact that he avoided many long marches, guard duty in mud and rain, and various other hardships that befell his mates. Tens of thousands of the latter determined that when they got their promotion to "civilian" they were going to become accountants. They were encouraged by

seeing the quick promotions which many got to Quartermaster, Finance Officer, or Paymaster. And the V. A. let them take their courses, more power to them.

The result, as above noted, is not encouraging. On the other hand it is not disheartening. Not all of them are determined to be CPA's; note the mechanics mentioned in the first paragraph. And the others have grand chances for making good in other lines, if need be, awaiting an opportunity to get into public practice. For example take another man in the group. His brother is a New York C.P.A. Had he stayed in New York, he could have been on his brother's staff. But marital considerations took him out of New York. He is presently employed as a clerk in a very small, but thriving, chain of stores. To become manager of one of the projected new stores he *must* know something about accounting. Only with that knowledge can he make his reports intelligently, and act as internal check on the bookkeeper the chain provides to do the actual pen-pushing. The chains are avid for keen young men to grow up into unit managers, district managers, area managers, etc. Certainly, they need to have more than a knowledge of debit and credit, however good. But without that knowledge, they stay clerks, or at best, assistant managers of small units.

This perfectly tremendous group of men (and quite a few women, too) has been almost entirely neglected by the professional magazines. The auditing case studies being published by the Institute are magnificent, for CPA's and their senior staff members. But where, in regular professional literature, can you find similar studies of the operation of internal check, whether it be in a one man enterprise, such as four of the group were heading for, or in a large chain? Certainly, such essays exist, mostly in the professional libraries to which the men who need them most have no access. Couldn't the professional publications do one, or both, of the following:

1. Establish a department of private accounting, with articles directed at the internal accountant, or the bookkeeper who wants to become one.
2. Devote some portion of their student department space to the student who is not going to go into public practice.

The Shoptalker is not going off at a tangent in making this proposal. He has discussed it with others, not just brother CPA's but clients, bankers, and others. He rejected one proposal that a new periodical for the private accountant be started. The reasons are too numerous to recite here, but any man who has had more than the slightest contact with printing costs, circulation development, and sale of advertising, will recognize them instantly. His point is, in summation, that the *public* accounting profession owes it to the *public* at large, to pay more attention to the non-public accountant.

And in closing, he wants it distinctly understood that the opinions expressed above are his, and not those of the publisher.

Notes on Some Recent New York State Unemployment Insurance Decisions

Conducted by SAMUEL S. RESS

Unemployment Insurance, Social Security, and Union Pension Benefits

Accountants are consulted regularly by clients regarding employees' social security and unemployment insurance, and disability benefits. Many employers also have retirement and pension plans. They have on their payroll over-age employees who have slowed down considerably in their work, due to the vicissitudes of the years. The inability of such employees to do their work as rapidly as in years gone by, may result in production bottlenecks in the plant with resulting increased production costs and the impairment of the economic operation of the plant.

> SAMUEL S. RESS has been an Associate Member of our Society since 1936. He is a member of the New York Bar and holds the Juris Doctor degree from the New York University School of Law, and the B.B.A. degree from The City College (New York) School of Business and Civic Administration. He is a tax consultant and has been a specialist in the payroll tax field since the inception of Social Security and Unemployment Insurance Laws in 1936. He has drafted legislation related to unemployment insurance, health insurance, wages and hours and workmen's compensation.
>
> Dr. Ress, who has written a number of articles which have appeared in *The New York Certified Public Accountant*, is a member of the Society's Committees on Clothing Manufacturing Accounting and on Labor and Management.

So as not to jeopardize the jobs of hundreds of other employees, as well as the capital investment of the employer, it may become necessary to replace the over-aged employee. Before separating him from your employ, you should make every effort to utilize the vast amount of experience that he may have acquired, perhaps in some other department where physical speed of doing the work is not a factor.

It is most advisable that the employer take into account provisions of union contracts, seniority rules, etc., before laying off the employee. Under such circumstances, the employee wants to know whether he is eligible for unemployment insurance benefits, social security benefits, and the company pension plan benefits.

A New York State Unemployment Insurance Referee's decision on November 9, 1950, in case #536-403-50R, held that a 73-year old claimant who had applied for and collected Federal Old Age and Survivors Insurance benefits as well as retirement benefits from his union, was also entitled to New York State Unemployment Insurance benefits.

The facts in the case were as follows: Claimant, an under-baster, filed an original claim for benefits on June 13, 1949, and reported through January 1, 1950, exhausting his benefits. He filed an original claim in the new benefit year on June 5, 1950. On August 15, 1950, an initial determination was issued, ruling him ineligible, effective June 13, 1949, because of unavailability, and overpaid $676 in benefits during the period from June 13, 1949, through January 1, 1950.

Claimant was 73 years old. For 15

years he worked for a contractor of men's clothes. He was a member of a union having contractual relations with the employer and was paid on a piecework basis. Because of his age, his rate of production slackened, and the employer was anxious to replace him with a younger employee. In June, 1949, he was laid off for lack of work. The employer resumed operations about August 15. Prior to that date, the claimant visited the shop to inquire for work, and was told that operations had not as yet been resumed. After August 15, he was replaced by a younger worker, and the employer told him that he had no work for him.

In June, claimant applied for Federal Old Age and Survivors Insurance benefits, and also applied to his union for retirement benefits. Until January 1, 1950, he was receiving $38.70 per month from the Federal government, and a like amount from his union. Beginning with January 1, 1950, his union retirement benefit has been $50.00 per month, and his Federal Old Age Insurance payments are now $62.90 per month.

During 1949, he continued to look for work by reporting to the unemployment service and applying to his union. Until at least January, 1950, he was able to work at a moderate rate of speed, but was not hired because he was not able to work fast enough to satisfy a prospective employer. During the past six months, his eyesight was impaired considerably, and he was unable to thread a needle.

The Referee held:

> ". . . The credible evidence adduced at the hearing compels the conclusion that claimant did not leave his job, but was replaced by his former employer. Despite his application for and receipt of retirement and old-age benefits, he continued to look for such work as he could perform, by application to his union and reporting to the employment service. He was therefore, available for employment. . . ."

After his eyesight failed however, he was not entitled to unemployment insurance benefits.

It should be noted that section 206 of the New York State Disability Benefits Law permits the scaling down of regular disability benefits where the claimant is also receiving social security or unemployment insurance or employer pension plan or certain other benefits.

Students and Unemployment Insurance Coverage

A series of decisions has just been handed down by the New York State Unemployment Insurance Appeal Board clarifying a perplexing situation that many accountants are faced with regularly. Employment of students between high school graduation in January and college matriculation in September, gives rise to the question, "Do we or don't we pay unemployment insurance and social security taxes on the earnings of these employees?"

In Appeal Board case #22,778-50, dated October 27, 1950, the Industrial Commissioner appealed from the decision of the referee overruling the initial determination that claimant was not entitled to be credited with his earnings in the base year 1948 with the employer in question, because he was a student within the meaning of Section 511.9 of the Labor Law.

The Appeal Board found:

> "It is clear in this case that after claimant's graduation from high school it was his intent to engage in the work in question as a permanent means of earning a livelihood and not as a temporary job subordinate to his schooling.
>
> "The referee properly held that claimant was entitled to be credtied with the additional earnings and was eligible for benefits (*Matter of Renee*, 293 N. Y. 501, reversing Appeal Board, 9166-43)."

However in Appeal Board Case #22,655-50, decided on October 20, 1950, it was held that:

> "The referee, in overruling the initial determination of the local office, concluded that two of the high school students, having completed their high school studies in June, 1948, worked in 'employment' as defined in the Law during the months of July

and August of that year. We do not concur in this view. Section 511.9 of the Labor Law reads as follows:

"9. Day student. The term 'employment' does not include services during all or any part of the school year or regular vacation periods as a part-time worker of any person actually in regular attendance during the day time as a student in an institution of learning.

"The referee, in effect, reasoned that the two students, upon completion of their high school studies, were no longer in regular attendance at an institution of learning. Consequently, during the period between such completion and their enrollment in college in September, 1948, their employment was held not to come within the exclusion provided in Section 511.9. In our opinion, it is immaterial whether their employment during the said vacation period followed their attendance at one school and was prior to matriculation in a different school. In reaching this conclusion, we are not unmindful of the Court's decision in *Matter of Morganstein*, 274 App. Div. 866, affirming Appeal Board, 14,609-47. In that case, the employee in question, having been graduated from high school and having obtained employment during the summer months, failed to gain admission to college after she abandoned her schooling.

"In the instant case, the two students in question continued their studies by matriculation in college at the beginning of the academic year. Their studies were merely interrupted by a vacation period. They were students and continued to be students. Consequently their services come within the exemption contained in the section quoted."

Appeal Board Case #22,008-49 dated October 27, 1950, stated that:

". . . Judge Conway, writing for the Court in the *Matter of Renee*, 293 N. Y. 501, reviews all the cases decided by the Courts under the provisions of Section 511.9 of the Law and the former sections from which it was derived. The court points out that in the *Matter of Purdue* (265 App. Div. 1028), the claimant was on the stage only one and one-half minutes. In the *Matter of Perroto* (266 App. Div. 811), the claimant worked six hours a day on four days a week. In the *Matter of Renee*, claimant was on the stage for only 40 minutes. In the *Matter of Eckler* (286 N. Y. 662), it was conceded that claimant was in part-time employment while in regular attendance at school during the daytime, and that the only question before the Court was whether or not the statute applied to claimant's base year which antedated the enactment of the statute. Because of the factual difficulty involved in determining whether or not the employment in issue in the cases before the Courts was full or part-time employment, the Court held that the intent with which the work was performed would aid in solving this factual problem. Where a claimant's work is the primary objective and his schooling is subordinate thereto, it should be deemed full-time employment within the meaning of Section 511.9 of the Law. However, where it clearly appears from the record that the work performed by a claimant is in fact full time, the intent with which it was performed is immaterial. . . ."

"In any event, the record in this case clearly shows that beginning June, 1948, work was the primary objective of the claimant and his schooling was subordinate thereto, so that even if we apply the *Matter of Renee* as interpreted by the Commissioner, claimant's work would not be excluded."

The foregoing cases should help guide us in those knotty tax coverage problems arising for unemployment insurance or social security tax purposes, where the employee in question may be as the songwriter puts it, "either too young or too old."

Ave Atque Vale

By Thomas W. Byrnes, C.P.A.

The present day CPA looking back on the immediately preceding fifty years, can take to himself the words of Milton:

> "Hence, loathed melancholy
> * * * * *
> Forget thyself . . .
> And join with thee calm Peace, and Quiet
> * * * * *
> But first and chiefest, with thee bring,
> Him that yon soars on golden wing
> Guiding the fiery-wheeled throne:
> The cherub CONTEMPLATION"
> * * * * *

To anyone who has been active in the business world during all of the past half century, the improved attitude of the public toward accounting practitioners is particularly noticeable.

In the early 1900's the aid of public accountants was invoked mainly in bankruptcy cases; in situations where it was necessary to determine, for claims against bonding companies, the amount of a trusted employee's peculations; or, for other protective reasons. The comparatively few concerns that engaged outside accountants regularly viewed them as necessary evils. The presence of auditors was, in most cases, considered by insiders and outsiders as an indication of "something wrong somewhere", and in many instances—notably bank examinations—the accountants worked at night to allay suspicion of financial weakness in the audited concern. Circularization of account balances was considered a sure sign that the confirming company was experiencing difficulty in navigating between financial Scylla and Charybdis.

Through the aggressively progressive activities of the national and state accounting societies, the CPA has gradually come into his own. Campaigns were inaugurated to show bank officials and other credit grantors the value of financial statements authenticated by State-approved CPAs. Colleges, sensing a growing interest in business as a profession, invited prominent CPAs to lecture before classes in political economy. Soon the demand for courses in commerce, accounts, and finance was such as to justify in many universities the establishment of a separate school for the study of these subjects. In addition to the efforts of the societies to give the business community a better understanding of the work of the CPA, and the endeavors of administrators of collegiate schools of business to prepare students to enter the profession, the individual practitioner has helped greatly in the march of the calling to professional rating. Goldsmith's description of the village schoolmaster applies with equal truth to the public accountant:

> "A man severe he was, and stern to view
> Twas certain he could write and cypher too;
> Lands he could measure, terms and tides presage
> And even the story ran—that he could gauge
> . . . And still the wonder grew
> That one small head could carry all he knew"

Competence and ethical conduct contributed immeasurably. Reputations were and are vigilantly guarded. As an instance of the sacredness in which reticense regarding clients' affairs is

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Thomas W. Byrnes, C.P.A., has been a member of the Society since 1911, and is a Certified Public Accountant of New York and New Jersey. He is also a member of the American Institute of Accountants.

Mr. Byrnes is a consultant to the accounting firm of Byrnes and Baker, C.P.A's. He was formerly an associate professor of accounting at Columbia University. He is a co-author of the text entitled, "Auditing."

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considered, the following true story comes to mind: In the days when the hypothecation of accounts receivable was viewed unfavorably by trade in general, a CPA had as clients a large out-of-town sheet metal producer and a local manufacturer who used the other's product to make an ultimate consumer's article. The latter concern borrowed funds from a credit company, pledging receivables as security. One day the CPA received an urgent request to call on the local client. He was told upon arrival that the other manufacturer had learned of the hypothecation of the accounts and had severely curtailed the local client's line of credit; also that an official of the credit company had said that the information must have been obtained from the public accountants who audited both companies. The CPA tried to assure his client that the charge was not true, that the same staff members did not visit both concerns, etc., etc., but the client was not convinced. The CPA then went to the out-of-town client's office and learned from the credit manager, who absolved the auditors, that he had heard of the hypothecation through trade channels and had confirmed the news *by writing to the credit company*. He produced, and loaned to the CPA, the carbon copy of his letter of inquiry and the credit company's reply, signed by its manager, stating *that the inquired-about concern was "one of its best accounts"!* Armed with this correspondence the CPA returned to the city, and demanded a conference at which were present the local client, the president and the manager of the credit company, and himself. The manager denied any knowledge of the matter until the CPA presented his evidence to the great embarrassment of the prevaricating credit company officials, and to the complete vindication of the auditors. In earlier days it was not unusual to attempt to hide such borrowings among the accounts receivable and to omit all mention of the loans or hypothecation in the records. Repayments to the lenders in such cases were made by the issuance of drafts unrecorded until paid through the local bank, and then debited by the borrowers to "Accounts Receivable," making it appear as though previously deposited customers' cheques had been returned to the bank, unpaid.

The part played by CPA's in developing methods of proper recording, introducing safeguards and other controls, and generally placing accounts on a clear, understandable, and informative basis, has been a factor in the rise of the profession, as have also been the CPAs interest and competency in administering community affairs.

For independence in reporting, the CPA would seem to qualify for the subject of the lines of Sir Henry Wotton:

> "How happy is he born and taught
> That serveth not another's will;
> Whose armour is his honest thought
> And simple truth his skill
>
> * * * * *
>
> This man is freed from servile bands
> Of hope to rise or fear to fall;
> Lord of himself, though not of lands
> And having nothing, yet hath all."

In hailing the future and bidding farewell to the past, CPA's should not forget that the present enviable position of the craft was attained largely through the sacrifices of early pioneers who gave freely of their time and effort to guide and develop the profession.

Office and Staff Management

THIS new department is being added to *The New York Certified Public Accountant* to provide a long needed service to Society members and other subscribers who are concerned with the problems of administration of an accounting practice. Though the flow of literature on this subject has increased materially in recent years, nevertheless much ground remains to be explored and charted. Moreover, such writings are often subject to practical limitations which, it is hoped, this column can overcome.

Two major functions will be served by this column: first, to act as a clearing house for questions and answers and, second, to publish brief notes on the diverse aspects of office management as gathered from contributors and other sources.

Society members and other subscribers who desire information on any phase of administration, or would like to ascertain a "prevailing practice", may submit such inquiries, in writing, to

The Editor, Office and Staff Management
The New York Certified Public Accountant
677 Fifth Avenue
New York 22, N. Y.

Responses will be made according to the best information reasonably obtainable and, if the subject is of general interest, they will be published in this column for the benefit of all readers. It must be recognized that practical considerations may restrict responses in certain instances and perhaps even exclude them. Nevertheless, there is a wide field for the exchange of information and ideas.

Members who are willing to share with their fellows ideas on improving accounting services (limited to administration matters) are urged to send them in to the Editor. Where such material is published the contributor (unless he suggests otherwise) will be given credit.

This department will augment the services of the Society's Committee on Administration of Accountants' Practice and will release material furnished by them.

* * * * *

At a recent meeting of the Committee on Administration of Accountants' Practice, a question was raised as to whether accountants dealing with administration, including office managers, staff managers, etc., would be interested in attending a monthly luncheon meeting for the direct exchange of ideas. Obviously, regional groups would be formed to save time and travel. The idea received such a good reception that it should be followed up and carried out if some general interest is displayed.

Would you be interested in participating in such a monthly luncheon meeting near your office? If so, drop a note promptly to The Editor and say so. Also, give him any ideas you may have on where, when, and how these meetings might be conducted.

* * * * *

Several inquiries were received by the Committee on how to lay out a staff room and obtain the maximum efficiency from staff working in the office occasionally or regularly. Undoubtedly, the questions of working conditions and orderly conduct are involved, as well as physical equipment and lay-out.

Ideas covering staffs of from 1 to 50 are solicited. This is a subject from which the contributor may eventually benefit as much or more as the inquirer. So, help this column get started by sending in a concise description of your staff room and supervision methods. Credit will be given contributors unless they request otherwise.

CORRESPONDENCE

To the Editor of *The New York Certified Public Accountant:*

In his article in the October, 1950, issue of *The New York Certified Public Accountant,* entitled "The Accountant's Opinion Before and After Auditing Procedure Statement No. 23," Stephen Chan offers the following as an example of a proper disclaimer of opinion in application of Statement No. 23:

> "Since we did not attend at the physical inventory taking, we are unable to express an opinion as to the financial statements as a whole. However, in all other material respects, it is our opinion that the attached financial statements present fairly the assets and liabilities of XYZ Corporation at December 31, 1949, and the operating results for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

It is my belief that the report section quoted is misleading and in direct conflict with the substance and spirit of APS No. 23. In the first sentence a disclaimer of opinion is expressed. The second sentence, however, contradicts the first because an opinion is therein actually expressed. In its bare and essential form the second sentence reads ". . . it is our opinion that the attached financial statements present fairly the assets and liabilities of XYZ Corporation at December 31, 1949, and the operating results for the year then ended." The introductory phrase "However, in all other material respects," logically can only be construed to be a qualification of the opinion which follows, and therein lies the deception. A qualified opinion has been rendered when a clear, unequivocal, and uncontradicted disclaimer of opinion was indicated.

Compare the form of disclaimer suggested by Mr. Chan with the following statement which appears in the Journal of Accountancy, October, 1950, issue (Auditing Practice Forum, p. 354), and represents a satisfactory application of APS No. 23.

> "Since the scope of our assignment did not include the confirmation of accounts receivable by correspondence with the debtors nor our verification of inventory quantities, we are unable to express an opinion on the financial condition of the A. B. C. Company as at December 31, 1949 or the results of its operations for the year then ended. In so far as we determined, within the scope of our examination, the attached balance sheet and related statements of profit and loss and surplus have been prepared in accordance with generally accepted accounting principles applied on a basis consistent with that of last year."

The significant difference between the two statements is that whereas Mr. Chan's statement clearly includes an opinion, both as to fairness of the statements and also their compliance with generally accepted accounting principles, (although preceded, inconsistently, by a disclaimer), the Journal statement distinctly includes a disclaimer but merely *comments* with respect to the application of generally accepted accounting principles to the preparation of the financial statements. Incidently, criticism could be directed to the Journal statement since the reference to accounting principles should have included the qualifying phrase, "except as to inventories and accounts receivable."

As authoritative support for these remarks I need only quote the relevant section of APS No. 23:

> "The independent certified public accountant should state that he is not in a position to express an opinion on the financial statements and indicate clearly his reasons therefor. He may also, if appropriate, comment further as to compliance of the statements with generally accepted accounting principles in respects other than those which require the denial of an over-all opinion."

It is clear therefore that any discussion, with respect to the compliance of the statements with generally accepted accounting principles, must take the form of a "comment" and not an "opinion." An opinion expressed as to "generally accepted accounting principles" (even if "in respects other than those which require the denial of an over-all opinion"), when preceded by a disclaimer of opinion on the statements taken as a whole, would only serve to negate the disclaimer. The spirit of APS No. 23 would thereby be vitiated, and the readers of statements would be greeted, not by that clarity of professional expression which APS No. 23 was intended to achieve, but by deceptive and confusing double talk.

It is my opinion that greater clarity would be attained, and less opportunity for confusion would exist, if the *comments* on generally accepted accounting principles were to precede the disclaimer of opinion. In that manner the natural tendency of the reader to confuse a "comment" with an "opinion" would be obviated.

Perhaps I should conclude this discussion with an apology for its length. I felt, however, that the importance of the subject matter justified this attempt at a clarification of the spirit and content of APS No. 23 which, apparently, have not been universally assimilated.

Very truly yours,
BENJAMIN NEWMAN,
Ass't. Professor
Business Administration Dept.

Adelphi College
Garden City, N. Y.

Reply by Mr. Chan:

Mr. Newman need not fear that I am in favor of vitiating the spirit of Statement 23. The impact of Statement 23 is only beginning to make itself felt and much discussion and clarification will ensue before it is understood by all. It is, therefore, essential that there be criticism and discussion of the type offered by Mr. Newman; for his efforts in this direction, he has my thanks.

The main purpose of my article was to trace the development of the thinking that resulted in this auditing procedure statement and to point out the background of the main principles thereof. The illustrative paragraphs offered at the conclusion of my dissertation were incidental. The disclaimer quoted by Mr. Newman from the October "Journal" has merit. However, conformity with Statement 23 may take various forms. There have been numerous illustrations in recent issues of the Journal of Accountancy of expressions by accountants, which apparently conform to the requirements of this Bulletin. It was not my intention, nor would it be possible with one or two illustrations, to cover all applications possible in actual practice.

Mr. Newman makes an interesting point in the next-to-last paragraph of his letter. We have not yet decided upon one standard paragraph to be used in most situations. However, it appears to me that the words "it is our opinion" in the second sentence of my illustration relate only to the items other than inventory and appear necessary; if these words were omitted, the accountant would be making a direct statement even stronger than the one objected to by Mr. Newman.

Very truly yours,
STEPHEN CHAN

New York, N. Y.

To the Editor of *The New York Certified Public Accountant:*

In perusing the article on "Pace Institute" by the Committee on History, appearing in the current, September, issue of The New York Certified Public Accountant, I noticed a slight error which, although not awfully important, I believe should be brought to your attention. On page 532 it appears that I completed the Pace course in 1911. As a matter of fact, I completed the

course in January, 1910 following which I sat for the New York State C.P.A. examinations in that month and I was fortunate in passing in all subjects at that time.

Sincerely,

HENRY E. MENDES

New York, N. Y.

Ed. Note: The source relied upon by the Committee for the original statement was page 15 of the first issue of *The Pace Student,* Vol. 1, No. 1, December 1915, which showed Mr. Mendes' record as, "New York Institute of Accountancy, 1911." We are happy to correct this inadvertent error.

Book Reviews

(Continued from page 701)

represented also by a series of diagrammatic charts which have been tediously and exactingly developed. The usual full range of transactions subject to audit has been covered. Later chapters deal specifically with the installation procedures to be followed in providing for such types of transactions as purchases and inventory control, sales, payroll, cash, and others.

The presentation of an accounting system report for a small retail business enterprise completes part one of the book. The report, though brief and hardly conclusive as to extent of coverage required of system reports, does afford a utilizable idea as to the general content and form of arrangement of material, as well as of the purposes and objectives of such a report.

At the end of each chapter are a number of appropriate questions and problems which, of course, are for use in connection with classroom work. These questions and problems are fully adequate to test the knowledge of the student, as well as his ability to apply such knowledge to specific situations.

The second part of the book devotes six chapters to varied businesses, compositely presented under the heads of: (1) Retail and Service Businesses; (2) Service Types; (3 & 4) Manufacturing — System Installation, and Applied System Procedures; (5) Trading Business, (6) Punched Card Accounting Methods. In the opinion of the reviewer, the presentation of certain systems in abridged form results in condensation that makes the material of little value for practical purposes; however, the key or outline knowledge included in the discussion can always be utilized by student or practitioner as a helpful starting aid in the field to which it applies.

As a final division of the last part of the book there is an "Appendix—Directory of Accounting System Information". For the person who desires to conduct the independent research which is invariably necessary in connection with any system installation, the appendix serves as an acceptable reference and guide. The sources of information, listed by name and address, have accessibility value in the acquisition of certain knowledge and practices in the systems field.

In general, "Accounting Systems" is excellently done, and although it may offer only slight advantages to many of the experienced members of the profession, it will enhance their knowledge to the extent that it produces some new idea or some new thought on the subject. As for the student, for whom the book was probably primarily intended, a large measure of constructive accounting—the formulation of records and the institution of coordinate procedures—has been made available to him. The book has been simply, clearly, and adequately developed for his purposes; namely, to obtain a firm foundation and a clear insight into the problem of system building.

To sum up, "Accounting Systems," with its topical "outline" and "directness" in presentation of essential system data, will prove particularly desirable for the student and will offer certain advantages to the practicing accountant.

OSCAR MAUTNER

New York University
New York, N. Y.

The New York Certified Public Accountant

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